Dear [name], dear All

Attached are some additional comments on the CMU consultation reply.

Many thanks, especially to you, [name], for all the work on this large topic so far.

Best wishes
Dear all,

As promised, I am sending you herewith our (Draft) contribution to the Commission Green Paper "Building a Capital Markets Union" (CMU).

I am including herewith both the clean version and a tracked changed version taking into account only the comments received in track version.

I am also including the power point presentation as well as a quick summary of our key opinions (as requested by [REDACTED]) which I hope you will find useful.

Please remember that our contribution should be based on our institutional role as advisor to ESMA and that therefore our input should be high-level and strategic.

Next steps and deadlines:
- Please send your written comments by 23 April. Please write directly in the draft using a track change to facilitate the drafting of the final document.
- Steering committee to review overall coherence and distribute the final document for approval on Thursday 30 April

Kind regards,

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Dear all,

I am sending you herewith the contribution of the SMSG to the Commission Green Paper "Building a Capital Markets Union" (CMU). I am including both a clean version and a tracked changed version taking into account all comments received as far as possible (given the relatively late input for some contributions).

Please note that the document is structured into three distinct parts:
- The SMSG’s preliminary comments
- The SMSG’s comments on the Commission’s 5 priorities for short terms action (prospectus regime; SME credit scoring; securitisation; long-term investment and private placement)
- The SMSG’s detailed comments on the Green Paper’s questions

We have set aside 2 hours tomorrow morning to discuss the document.

Please note that I will make a power presentation trying to summarise our current draft position. That’s quite a challenge given the breadth of issues that we are trying to cover!

See you tomorrow!

Kind regards,

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Dear all,

Apologies for another memo to read as background on the CMU, but attached is a fairly technical internal briefing document we have put together on the subject of market structure for SME Growth Markets and as well as less liquid securities. Hopefully you might find it interesting in the overall CMU context.

See you tomorrow.

Yours
In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises’ (SMEs) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium-sized companies to have access to funding (through private equity and venture capital funds or through capital markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Preliminary comments

In its initial advice, the SMSG stressed that using capital markets brings many advantages to SMEs including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they are able to provide (in light of Basel III, possibly the Volcker rule, the future structure of banking paper etc.) that would make it increasingly more difficult to extend loans to SMEs. The development of the Capital Markets Union may promote alternative funding sources (both equity and debt) to facilitate growth. There is not just one method through which to increase access to funding for SMEs: Fostering a stable, positive environment and incentivising companies through attractive and diverse funding options is essential. In its 2012 report, the SMSG concluded that regulatory initiatives often have a negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that there is a need to focus on how to provide to each category of investors the right incentives to encourage this broad community to invest not only in equity but also in debt issued by smaller companies and how to structure an efficient, transparent and competitive market so that investors can get reliable liquidity in their investments. This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens as individual investors. In addition, the state of development of capital markets, the needs, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed in the EU. It is likewise important that actions focus on the financial sector as a whole and Widen and deepen European capital markets, across not only the euro countries, as in the Banking Union, but across all 28 EU Member States, not as a set of silos.

In order to achieve the objectives of the Capital Markets Union, it is – on the one hand – essential to develop initiatives to restore investor trust and confidence, in order to revive demand for new sources of funding. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available across Member States. On the other hand, it is necessary to keep in mind that investors do not act within national boundaries and that a supportive framework is needed.
The Green Paper identifies five priority areas for short term action including the following:
1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;
2. Widening the investor base for SME and improving credit information on SME;
3. Building sustainable securitisation;
4. Boosting long-term investment;
5. Developing European private placement schemes

General comment:
Unfortunately none of these five priorities for the short term involves individual investors, except – but probably marginally – ELTIFs. However, the Commission itself rightly points out that “households are the main source of funds to finance investment” (Green Paper on the long term financing of the European economy). Therefore, a successful CMU must involve and attract individual investors. “It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors... The protection of investors should play a major role in building the CMU” (Steven Maijoor, Chair of ESMA). Improving investor protection and clarifying choices for consumers must take a prominent place in the CMU Initiatives.

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:

1. The Prospectus regime - lowering barriers to accessing capital markets and the proposals regarding

An effective overall funding environment in Europe must seek to:

- Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.
- Attract a wider set of investors to smaller, growing businesses by reducing the regulatory and fiscal burden on such SME investors.

The SMSG SME believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no 'one-size fits all' solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SMSG SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

- More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.
- Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS) - should be optional for SMEs.

I have serious doubts on that. We are discussing one proposal for a unified market, but that remark goes on just the opposite direction. If not IFRS, it would mean that national reporting standards could be applied. But those standards would not be understood by investors from other member states, so they would not invest in such companies. Instead of broadening the ‘investor’ base it could narrow it drastically. IFRS is a very important tool for creating a CMU, which means a single rulebook that is understood by all the participants throughout the whole EU. Analogue to EU corporate legislation (for instance the very successful Sarbanes Oxley Act) a legal framework could be proposed in the fields of accounting, transparency and fiscal legislation underlying freedom of choice and thereby reflecting both proven national legal systems in Europe and individual needs. A further possibility specifically targeting SMEs and financial reporting requirements would be a streamlined down version of the International Financial Reporting Standards (IFRS), for instance with regard to the necessary attachments, comparable to the size classification used in the EU Accounting Directive. This way, possible barriers to accessing the market could be greatly reduced. The effects of such links to the capital market on financial reporting and the publication of financial information (e.g. in a prospectus) would need to be sufficiently measured.

Something seems to be missing here?
• Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.

• Pre-IPO registration process - prior to the formal offer of securities – would help issuers take advantage of the relatively short term ‘IPO window’. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.

• Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and or key adviser. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained.

• EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMEs. In its current form, the Prospectus – and in particular the “Summary Prospectus” - is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

Alongside investor interests for standardized credit data, a further focus must be put on taking the interests of small companies and small banks such as savings and cooperative banks into account, i.e. the ones having to provide such data. A European solution for company data needs to be designed in such a way that any provision of data takes place on a voluntary and not a mandatory basis, i.e. only when a company is interested in gaining access to larger and international investor groups in the context of funding measures via the capital markets.

In this respect, the SMBC also points at the importance of having to consider a Central Rating Repository. Most issuers are not aware of smaller, niche rating agencies. A Central Rating Repository would make the ratings by smaller niche rating agencies publicly available, and at the same time contribute to the lesser known agencies be better known.
Valuation: Standardized credit scorings can help to reduce information asymmetries. Though at the same time highly redundant business models based on standardized credit scorings and ratings can lead to significant systemic risks. Therefore investors need also to take on responsibility themselves for adequate risk assessments of their exposure.

3. Securitisation and corporate debt - building debt market financing for SMEs

When exploring the topic of fixed income market financing for SMEs, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an additional definition for the "Entreprises de Taille Intermediaire" which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally. Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies. Further, in the context of the creation of new securities (e.g. private placements), the use of market infrastructures should be promoted, as they increase stability by using safe, stable and reliable electronic systems, allowing e.g. for notary functions and reconciliation measures (i.e. ensuring integrity of the issue). Services provided by market infrastructures further facilitate an extensive international investors' reach: not only domestic investors are reached, but also investors on a European and global level may be reached. This reduces the "home-bias" phenomenon.

Alongside banks, companies operating in the real economy also make use of asset-backed securities to gain funding on the capital market. Such securities play an important role for companies, offering advantages - alongside being an attractive way of gaining funding - with regard to corporate indicators, credit line utilization and reporting requirements not available when using other capital market products. Asset-backed receivables in the form of trade, financing or leasing receivables (the latter generally coming from corporate sales funding subsidiaries) are for the most part sold to so-called "asset-backed commercial paper (ABCP) programs" run by banks ("sponsor banks").

Features of ABCP funding programs:

- Transaction volumes exceeding ca. €15 million; volumes exceeding €300 million may also be run via co-funding structures, in which two or more ABCP programs jointly finance a single pool.
- Liabilities in different currencies or jurisdictions can be bundled (e.g. when including a corporation's foreign subsidiaries in a program).
- With regard to trade receivables, it is common practice to provide coverage via trade credit insurance in addition to structural credit enhancements (e.g. discounts on the purchase price, reserves, etc.).
- ABCP programs bundle the individual transactions, refinancing the total volume through the is-
The “sponsor banks” additionally provide liquidity lines to their ABCP programs. Their purpose to make liquidity available to the program, should it prove difficult to place sufficient ABCPs on the capital market or should transactions turn out to no longer be suitable for capital markets (e.g. in cases where the vendor has become bankrupt or other material events).

Where an ABCP program’s liquidity lines cover not only the dilution risk but also the credit risk, one speaks of “fully-supported programs”; from a structural point of view these contrast greatly to other forms of asset-backed securities.

**Refinancing of SME bank loans through securitisation**

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, while banks for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a show stopper; and the structurally lower visibility of a smaller business a real difficulty.

It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as of end 2012, the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIF report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. Pooling and standardisation of loans is needed to ensure transparency and comparability. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.

In addition, transparency about the origination of loans and about the credit granting process of the originating financial institution would be meaningful information with regard to transparency of securitisation.
Corporate bond markets

There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. There are three notable initiatives in Europe of this nature: the initial Bond Offerings launched by NYSE Euronext in 2012, modelled on equity IPOs; the German Bond Market created by the Stuttgart Stock Exchange in 2010; and the LSE CIB market launched in February 2010.

The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of these mixed results.

There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly though the desired expansion of securitization to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channeling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

4. Boosting Long-term Investments

In its 2012 advice, the SMEG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities as well as to private equity and venture capital funds. If pension funds covered by IORPDS would also have to comply with Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds' ability to invest into equity and other long-term assets, but may over time lead to companies being faced with increased costs for pension benefits, as pension funds find it difficult to generate the necessary long-term returns to match their long-term liabilities.

Given the plethora of Investment funds in Europe ($3000 versus 8000 in the US which is a more than twice bigger market), it will be difficult to justify the addition of yet further additional categories of long term funds such as European Long Term Investment Funds (ELTIFs), European Venture Capital (EuVECA) and European Social Entrepreneurship Funds (EuSEF), and of a Pan-European personal pension plan.
5. Developing a European Private Placement scheme

For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldschein) providing approximately €15 billion of debt in 2013.

The German Schuldscheidenlärchen Market has a remarkable volume: EUR 68.7 bn with new issuance in 2014 of EUR 11.7 bn shows that Schuldscheidenlärchen are a set financing instrument for especially medium sized enterprises (ca. 60% are non-listed companies) which should be considered as reference when thinking about European solutions. Investors have a buy and hold perspective which is also reflected in the average maturity (5.3 yrs).

It’s long track record with very low default rates and the required legal certainty makes the Schuldscheidenlärchen an attractive asset class for investors.

These markets provide financing through the use of so called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets. This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be "privately placed" to individual or small groups of institutional investors as in the case for example of reverse enquiry EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the European Private Placement Association (EU PPAA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

Any increase in transaction costs, for example through further transparency requirements or an extension of the framework – like the LMA/ICMA standard requires – would make access to this funding instrument more difficult for SMEs.

1. ECPA, ECPA, ECII, FIP, ICII, SICAP, BMA, BMA, BPMMA

Because in Hungary doesn’t have good practice in this subject, I would like to highlight the successful German practice of Private Placements: The Schuldscheidenlärchen. As far as I know in particular SMEs of sufficient size (as well as large sized companies) are able to engage in capital markets financing at relatively low transaction costs due to the very flexible level of required documentation (15-15 pages) even no external ratings are necessary. There is a growing demand from international investors as well as European issuers who are increasingly welcoming this lean documentation standard on account of the stable German legal framework. I hope our German stakeholder member should confirm the above mentioned.
This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements. Most recently the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:

• Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.

• The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.
**Detailed response to the Commission’s Green Paper**

**Improving SME access to finance:**

The Green Paper’s analysis:

- for SMEs: diversity and scant credit information, preference to relationship-based lending (hence banks);
- for start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring;
- for mid-caps: access to public markets is costly;
- Corporate bond markets lack transparency and standardisation;
- Crowdfunding remains focused on national markets.

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

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME’s access to finance and investor’s ability to invest.
- “Regulatory Reconciliation”: is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e.g. CRD IV/CRR, MiFID II/MIFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.
- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them. Initiatives to promote financial literacy, to develop a capital market culture and to revive investor trust are needed.
- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.

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• Review of categorisation of high net worth individuals/business angel type investors as ‘retail’. The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital and other early stage fund managers (and their end investors) in the AIFMG and the EUVECA and EuSEF passporting schemes.

• Creation of public support specific to these companies (for example, subsidized credit lines).

• Commissioning a comparative review of the EU and US high yield debt markets with a specific focus on providing investors access to smaller companies at mutually attractive terms.

• Developing a flexible EU “bankruptcy regime” (similar to the Chapter 11 provisions in the US). Further harmonisation/standardisation/removal of barriers.

  In addition the following tax incentives could be considered: if start-ups were allowed to offset eg social charges against their tax-loss carry forwards which they typically accumulate during their early years of existence rather than eventually selling them off to a more mature company (who will use them to offset tax on corporate profits), this would help reduce their overall funding needs in the beginning while allowing them to employ staff during critical growth stages of their development.

• Revive individual investors’ involvement in equity markets: in 1970 individual investors held directly close to 40% of EU listed companies, compared to about 13% today.

• Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment products by standardising, simplifying, streamlining and reducing the cost of - packaged investment products.

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?

When SMEs decide to use rating agencies, incentives, also for corporate debt rating, could be considered as follows:

• Reducing information asymmetries between issuers and investors and, as such, the risk premium demanded on loans to SMEs.

• Protecting investors, through the provision of additional information about the additional risks they are incurring with these types of investments.

• Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by recognized External Credit Assessment Institution (ECAI).1

• Reducing costs by making the assets accepted as collateral in liquidity providing operations to banks by the ECB, if the ratings are issued by recognized ECAI.

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

There should be two separate types of ELTIFs, those catering for the needs of institutional investors and those catering for the needs of retail investors. If all ELTIFs are modelled on the needs of retail investors (liquidity, investor protection etc) it risks making them unnecessarily expensive for the institutional investors.

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1 Credit Assessment Institutions (ECAI) is the cost structure. Bearing in mind the lack of personal relationship to SME owners and the low level of standardization in the SME market it is very doubtful that such institutions can run a proper and ongoing risk assessment for SME at adequate costs (looking at transaction risk). Besides that cross correlations are very difficult to model, especially but not exclusively with regards to SMEs. This is important when looking at the aim of the CII to foster SME loan securitization.
Any successful development of ELTIFs should consider:

- eliminating the plethora of already existing long term fund categories which are nationally incentivised (nine such categories exist in France alone, all with tax incentives).
- Granting the "most favoured nation" clause to ELTIFs for its tax treatment in Member States
- Selling the same ELTIFs to all investors — retail or not, and ban funds of funds which add a layer of fees
- Applying the product disclosure rules of UCITS funds;
- Making listed small cap equities an eligible asset class.
- Allowing as well closed-end listed ELTIFs to address the liquidity issue
- Setting a high threshold for minimum investments in ELTIFs; those should be "advised" only to qualified and very financially literate investors.
- Considering accounting treatment at banks or insurance companies investing in ELTIFs that does not impose mark to market; as long as they are held to maturity.

Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFs can play an important role in capital market funding in the EU, but they need more official support. One of the major barriers ELTIFs will face in trying to develop into a genuine cross-border fund structure, with a UCITS-like passport, is the lack of a level playing field for non-bank providers of credit when compared to bank lenders. Because ELTIFs are intended to invest in illiquid, often private (as opposed to public) assets, ELTIFs may need to operate only nationally if at all, given the various national restrictions on banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFs, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

- the inability of funds to originate loans;
- the need for a banking licence to originate loans;
- the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
- restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
- different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

EU could undertake a review of the current obstacles to cross-border fundraising which have eg arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.
In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Private Placement Market Guide published on 11 February 2015), we suggest that a revision of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation (EU) 2015/35) should be considered. Although the final calibrations in the Delegated Act (the "long term guarantees package") has helped remove obstacles to investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investments in private placements, as well as more generally in long-term assets.

Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

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

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, e.g. rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.

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?

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bonds markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap...
borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to
greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues
from the rest of the sector could come to resemble the more bespoke private placement market, on the
other hand.

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

As a preliminary comment, it is important to note that green bonds like any other listed bond come
under the scope of existing financial regulation both at the EU and national levels. Green bonds are
therefore not being issued in any form of regulatory void. They also benefit from a successful self-
regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary
process guidelines that recommend transparency and disclosure and promote integrity in the develop-
ment of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated
document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process rep-resented by the GBP is preferable to a top-down normative approach leading for example to a green bond
"label" formally recognized at a regulatory level. This would risk creating unnecessary market segmenta-
tion, as well as the perception of potential liabilities for issuers that could dissuade them from entering
the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond
market as they both experience additional costs compared to mainstream alternatives, and/or in order
to maintain or accelerate the development of the market in support of wider public policy objectives
related especially to the fight against climate change. The GBP require additional work from green bond
issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g.
dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green
bonds and the underlying environmental projects. These costs are not reflected in the economics of
green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most
likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal
identified above of avoiding a top down normative approach to these securities.

At this stage, it is therefore most likely preferable to allow the green bond market to continue its de-
velopment based on its current strong momentum and successful self-regulation (within the safeguards
provided by mainstream financial regulation). An active dialogue can be maintained on the need for
possible future incentives between the Commission and national authorities on the one hand, and indus-
try associations and self-regulatory initiatives on the other.

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

The ESMA SMEG is in favour of the distinct and separate SME market regime under MiFID II and MAD

13
The SMSS believe that such a regime would have the following benefits:

- recognise the role such markets currently play in the EU funding environment;
- ensure that changes to EU financial services regulation do not adversely impact small caps;
- cater for a secondary market for trading shares of less liquid SMEs;
- allow for further development of regulatory and fiscal EU policies to attract investors to this asset class.

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

Crowdfunding is one of the emerging financing models that contribute to helping start-ups move up the “funding escalator”, as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refers to open calls to the wider public to raise funds for a specific project. These calls are often published and promoted through the Internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds.

- Non financial crowdfunding. Includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- Financial crowdfunding, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, Understanding Alternative Finance, Peter Baeck, Liam Collins, Bryan Zhang, November 2014) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.

Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects raise funds are themselves also relatively small business. According to the same report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200,000
pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no previous investment experience. Estimation of activity for the European Union is not easy, and overall figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax reliefs to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, raising awareness, etc.) addressed at promoting its usage as a financing vehicle.

ESMA recently published an Advice on Crowdfunding to European Parliament, Council, and Commission taking into account the need of promotion and clarification, while at the same time preserving investor protection at its highest.

The main objective of the report is to assist NCA's and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.

Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is pure reception and transmission of orders, in which case a 50.000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission's programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU-based platforms that could compete with the US ones.
Supply side: institutional investors

The Green Paper's analysis of current regulation and tools

UCITS V and AIFMD
- The directives are still insufficient to reduce cost and diversify managed funds investment.

On pensions and insurance:
- There could be a review of Solvency II (and CRR) delegated acts to adapt prudential rules for identified sub-classes of lower-risk infrastructure investment.
- The Commission asks which sub-classes should be prioritised for.

On professional pensions:
- Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

Private equity and venture capital:
- EuVECA and EuSEF Regulations - the clause impeding managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
- Commission asks which measures could be proposed to: increase scale of venture capital funds (both via public and private contributions, improve exit strategies and supply for investors and boost supply of venture capital to start-ups.

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as those funds are typically closed-ended and unleveraged; if not – the €100 m threshold would apply) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. However, the potential to be caught by AIFMD will deter funds from gaining scale which is ultimately needed to allow a fund to diversify and achieve attractive returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds >€100m compared to 227 in the US. The SMEs are aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequences in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive.1

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU countries there are still institutional barriers to larger investments by eg pension funds, insurance funds

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1 EarlyBird Europe Venture Capital Report – July 2011
etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so called prudent person rules.

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?

Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given the lower liquidity of the underlying assets.

There are 33 000 funds in the EU versus 800 in the US. The average size of an EU fund is about € 200 million versus € 1600 million in the US, i.e. 8 times bigger. The annual fees of EU equity funds are 1701 bps (2011: last available info) versus 74 bps in the US (2013). The number of funds must be drastically reduced, especially AIFs as they are more numerous (about 20 000), smaller and often only distributed on a national basis. For example, Better Finance is proposing to ban AIFs in retail-packaged products such as unit linked insurance contracts and pension plans, in favour of UCITS.

For individual EU investors the problem is compounded by the fact that direct fund holdings account for only 7 % of their financial assets: most economic retail ownership of funds is through wrappers that add yet another layer of costs further reducing the net returns to EU citizens.

Review of the tightening of the national private placement regimes for cross-border marketing of especially below threshold funds that followed as a result of the implementation of the AIFMD. Review of the practice of many national CAs to impose additional charges and/or additional conditions (like a French paying agent) for managers who have already been granted the EU-passport in their home jurisdiction.

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?

EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any future proposals to introduce similar regulation for pension funds must not place conditions that adversely impact the ability to directly or indirectly invest in small caps. The capital and liquidity requirements under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest and most liquid blue-chip equities or even only interest bearing instruments like government bonds due to the lower risk weightings for these than equities in general and deter any existing appetite for smaller companies. An appropriate exemption for direct or indirect investment in small cap securities should be implemented.

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

The European Venture Capital Funds Regulation (EVCFR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes holdings in SME markets as 'qualifying portfolio companies'. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest institutions do) nor have necessarily worked in the financial industry.

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?

As mentioned above through not imposing overly restrictive capital requirement, not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class. Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor. Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company's development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the "valley of death"...

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

- Commission asks how to increase participation in UCITS by cross-border retail;
- Share best national best practices in the development of simple and transparent investment products for consumers;
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

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

Review of UCITS directive to identify ways to attract dedicated UCITS funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the advantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make Investments directly in SME issuers.

UCITS are much more cross-border than AIFs already because the two major domiciles for UCITS are largely “off-shore”: Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).

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

ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better ensure existing investor protection rules. For all this they need their resources to grow, not to be cut.

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

General comment

The savings rate of household is already quite high in Europe. Also, contrary to what one often reads, individual investors are not more short term nor more risk averse than other investors:

- 62% of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80% of their total savings are long term if property is taken into account.
➢ DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least)
➢ By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8% from 2001 to 2010: way before Solvency II.
➢ The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.
➢ The involvement of individual investors in SME markets is about twice as large as it is in blue chips
➢ What individual investors do not like is high risk - low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the first category returned a net return of 20% since 2000, the latter a negative one of minus 14% over the same period.

• Review of categorisation of high net worth individuals/business angel type investors as 'retail': The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

• Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax offsetting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.

• Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected will they be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders' voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.

• Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.

• Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.

• One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are eg incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax deductible expenses for a company and then taxed in the hands of the recipient, divi-
dends are subject to double taxation (made out of taxed corporate profits and then taxed again in the hands of investors)

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

To our knowledge, the longer term the retail investment products are the more complex. This is why a simple, standardized Pan-European personal pension plan is needed.

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

Yes:
- The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further standardise and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance Mediation and IORP Directives should be amended in order to make their summary documents more standardised, simpler, shorter, in plain English and more comparable between each other and with other investment products.
- IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder associations to easily collect proxies from their members. Next to its involvement in the operation of the proxy advisory industry, ISSA should additionally get involved in improving the proxy voting process e.g. by ensuring for standardised workflows within the intermediaries chain or by developing harmonized EU-wide accepted proxy forms.
Supply side — non-EU investment

Attracting non-EU investment:

- The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
- The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

EU needs to continue to ensure "reciprocity", i.e. not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market internationally.

Given that many regulatory initiatives are newly implemented in Europe, and taking into account that markets have become global, the topic of third-country recognition is important. In general, the same level of requirements for third-country enterprises providing their services in a European Member State should be maintained in order to preserve the desired standards of services in the EU. The potentially lower standards from third countries for the same services should not be introduced via recognition procedures. This is particularly sensitive with regard to foreign competition, affecting the growth potential for EU companies.

Therefore, a fair balance needs to be found to allow non-EU companies to provide their services in Europe.

It is important to ensure that global standards and rules put in place by institutions such as the International Organization of Securities Commissions, the Bank for International Settlements and the Financial Stability Board are carefully considered when drafting regulation in order to avoid regulatory arbitrage that could have negative consequences for growth. Safety standards, risk mitigation measures and data protection rules, for example, should be put in place at the highest level possible. A "race to the bottom" should be avoided, so that individual players cannot exploit weak regulatory regimes. Isolated national regulation should be avoided as well.

On the other hand, it is important that European companies are allowed to enter third country markets to provide services abroad. It should be noted that other countries may have high barriers of access to their markets, which is another reason to consider initiatives to ensure that EU market participants are able to offer their services outside the EU on a level playing field with non-EU providers.

In this regard, reciprocity should be requested and maintained with regard to third-country regimes.

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?
Improving the Investment Chain

Commission's analysis regarding the single rule book, enforcement and competition includes:
- The single rule book is a major step forward to enforce EU regulation consistently but the single rule book's success depends on consistent implementation and enforcement.
- Suprervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
- Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
- Market Infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

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

Regulatory reconciliation is a key in the next years.

The Capital Markets Union should ensure that the long-term goal is to reduce the regulatory burden to what is essential. Additionally, loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences.

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?

Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to "crack-down" on national CAs who go further than what has been envisaged under certain Directives?

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?

The overall legal framework for securities varies widely by country. For example, legal barriers make it much more complex to hold securities cross-border, and lead to higher costs for transactions. In addition, they cause difficulties and uncertainty among investors when they exercise their rights abroad and should therefore be targeted, e.g. harmonise that end-investors holding their shares in nominee/ custody are fully able to make use of the voting rights stemming from their shares.

Given that legal uncertainty of this nature acts as a barrier to financial stability and growth, the European Commission has been examining barriers within securities markets for several years, with the aim of creating a stable and efficiently functioning single market.

Continued harmonisation of rules and standards is essential to eliminate costly barriers and reduce complexity for investors and companies. Initiatives in this area, building on the Single Rulebook as a
harmonised regulatory framework, should increase the attractiveness and returns on investment, thereby stimulating economic growth.

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?

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?

Without common applied corporate governance principles/control the Union cannot be done successfully. Thus further harmonisation of national rules and standards are needed in order to eliminate costly barriers and reduce complexity for investors who do not act within national boundaries.

The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and site) company statutory reporting info for the last 12 years is available (for purchase) via the web-site www.altabolys.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

Language is another impediment.

Despite significant progress towards the European single market, capital markets are still fragmented with regard to company law, corporate governance rules, creating barriers that hamper the free flow of capital. Those barriers across regions make cross-border investments complex and expensive, and therefore less attractive. The Single Rulebook has not yet been fully achieved.

Continued harmonisation of national rules and standards in order to eliminate costly barriers and reduce complexity for investors is essential.

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

Harmonization proposals should look into the nature of the insolvency proceedings (administrative vs. judicial procedure). In any case, measures should include among others the opening or the management of an insolvency proceeding as well as the scope of liability of involved parties. Further harmonization could include initiatives to overcome the current restricted local effect of insolvencies in case of group companies.

Different national Insolvency laws make cross-border services expensive. Reducing the existing inefficiencies will play an important role in unleashing the wider macroeconomic benefits from integrating European securities markets.

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?
31) Are there other issues, not identified in this Green Paper, which in your view require action to achieve the Single Market? (If so, what are they and what action could be taken?)

31) How can the EU best support the development of the emerging capital markets?

32) The financial services sector is one of the most transparent and least risky sectors of the economy. The increased transparency and disclosure requirements for the financial services sector would also increase the cost of raising capital and could raise costs as a result of increased supervision. This would reduce the cost of raising capital and could raise costs as a result of increased supervision. This would reduce the cost of raising capital and could raise costs as a result of increased supervision.

33) What is the role of the Member States in this context? How can the EU best support the development of the capital markets?

Review of EMU: Aid risk capital guidelines to allow for effective leverage schemes, to be adopted by Member States. The guidelines should recognize the role of expansion capital as a genuine private capital.

The guidelines may be considered in order to encourage more long-term holding (i.e. better pre-tax offsetting of gains and losses, and the push forward of realisation proceeds to re-investment). Creation of a risk capital guidelines for certain investment products, in particular those of interest.

The guidelines should be balanced with any risk of malinvestment of capital.
heighened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average ELiMa amounts to 15% and exports total 45%. Elite Companies have been involved in one AIM listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the UK in 2014, where it now counts 33 participants.

Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a "work zone" supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is "capital neutral" to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.

It is made up of different phases:

- **1st phase - GET READY**: It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities.
- **2nd phase - GET FIT**: New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support of a dedicated external advisory team.
- **3rd phase - GET VALUE**: Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European Elite community of advisers, investors and stakeholders.

Elite was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average ELiMa amounts to 15% and exports total 45%. Elite Companies have been involved in one AIM listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the UK in 2014, where it now counts 33 participants. In December 2014 Borsa Italiana and the London Stock Exchange Group have presented the imminent launch of a Europe-wide Elite program at the European Parliament; it will be a European platform deeply rooted in each domestic market, through partnerships with local institutions enabling companies to access support and advice throughout Europe.

- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.
- Transaction costs should be lowered towards the US level.
• Actual Consolidated tape - free for individual investors after a few minutes - should be now eventually enforced in Europe. A debate on the consolidated tape, as included in the data and reporting section, should be addressed within MiFID II. Article 90.2. MiFID II even includes a review clause for the CTP regime. To avoid double regulation, its strongly recommended to delete the part on consolidated tape.
Dear All,

Maybe you have already seen that: European Commission has published an Action Plan on Building a Capital Markets Union.
At first reading I can see that some of our recommendations were seriously taken in to account 😊

Best wishes

Action Plan on Building a Capital Markets Union

{SWD(2015) 183 final}
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# Contents

INTRODUCTION................................................................................................................................. 3

1. THE PATH TO GROWTH – FINANCING FOR INNOVATION, START-UPS AND NON-LISTED COMPANIES ................................................................................................................................. 7
   1.1. Financing the start-up phase................................................................................................. 7
   1.2. The early expansion phase ................................................................................................. 8
   1.3. Supporting SMEs seeking finance ..................................................................................... 9
   1.4. Loan-originating funds ..................................................................................................... 10
   1.5. Private placements .......................................................................................................... 11

2. MAKING IT EASIER FOR COMPANIES TO ENTER AND RAISE CAPITAL ON PUBLIC MARKETS ................................................................................................................................. 12

3. INVESTING FOR THE LONG TERM, INFRASTRUCTURE AND SUSTAINABLE INVESTMENT ................................................................................................................................. 15
   3.1. Improving the investment environment through the regulatory framework ................... 15
   3.2. Supporting long term and infrastructure financing .......................................................... 16
   3.3. Harnessing finance to deliver environmental sustainability .......................................... 17
   3.4. Call for evidence on existing regulatory framework ......................................................... 17

4. FOSTERING RETAIL AND INSTITUTIONAL INVESTMENT ................................................. 18
   4.1. Retail investors ............................................................................................................... 18
   4.2. Institutional investors ..................................................................................................... 20

5. LEVERAGING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY .......................... 21

6. FACILITATING CROSS-BORDER INVESTING ....................................................................... 23
   6.1. Legal certainty and market infrastructure for cross-border investing .............................. 23
   6.2. Removing national barriers to cross-border investment .................................................. 24
   6.3. Promoting financial stability and supervisory convergence ............................................ 26
   6.4. Facilitating international investment .............................................................................. 27

7. NEXT STEPS AND MONITORING .......................................................................................... 28
INTRODUCTION

The Commission's top priority is to strengthen Europe's economy and stimulate investment to create jobs. The EUR 315 billion investment plan, up and running less than a year after the Commission took office, will help to kick start that process. To strengthen investment for the long term, we need stronger capital markets. These would provide new sources of funding for business, help increase options for savers and make the economy more resilient. That is why President Juncker set out as one of his key priorities, the need to build a true single market for capital – a Capital Markets Union for all 28 Member States.

The free flow of capital was one of the fundamental principles on which the EU was built. Despite the progress that has been made over the past 50 years, Europe's capital markets are still relatively underdeveloped and fragmented. The European economy is as big as the American one, but Europe's equity markets are less than half the size, its debt markets less than a third. The gap between Member States is even bigger than that between Europe and the US. More integrated capital markets will lead to efficiency gains and support Europe’s ability to fund growth.

Capital Markets Union will reinforce the third pillar of the Investment Plan for Europe. It will offer benefits for all 28 Member States, while also buttressing Economic and Monetary Union by supporting economic convergence and helping to absorb economic shocks in the euro area, as set out in the report of the Five Presidents on Completing Economic and Monetary Union.

Stronger capital markets will complement Europe’s strong tradition of bank financing, and will:

- **Unlock more investment from the EU and the rest of the world**: Capital Markets Union will help to mobilise capital in Europe and channel it to all companies, including SMEs, infrastructure and long term sustainable projects that need it to expand and create jobs. It will provide households with better options to meet their retirement goals.

- **Better connect financing to investment projects across the EU**: Member States with small markets and high growth potential have a lot to gain from a better channelling of capital and investment into their projects. Member States with more developed capital markets will benefit from greater cross-border investment and saving opportunities.

- **Make the financial system more stable**: integrated financial and capital markets can help Member States, especially those inside the euro area, share the impact of shocks. By opening up a wider range of funding sources, it will help to share financial risks and mean that EU citizens and companies are less vulnerable to banking contractions. Furthermore, more developed equity markets, as opposed to increased indebtedness, allow for more investment over the long term.

- **Deepen financial integration and increase competition**: more cross-border risk-sharing, deeper and more liquid markets and diversified sources of funding will deepen financial integration, lower costs and increase European competitiveness.

Put simply, Capital Markets Union will strengthen the link between savings and growth. It will provide more options and better returns for savers and investors. It will offer businesses more choices of funding at different stages of their development.
Why is it worth doing?

A few examples illustrate the potential benefits. Compared with the US, European SMEs, receive five times less funding from capital markets. If our venture capital markets were as deep, more than EUR 90 billion of funds would have been available to finance companies between 2009 and 2014. If EU securitisations could be revived – safely – to pre-crisis average issuance levels, banks would be able to provide an additional amount of credit to the private sector of more than EUR 100 billion. And if SME securitisation was re-built to half the crisis peak it could generate EUR 20 billion of additional funding. Investment needs are also great – for example, it is estimated that for the EU’s transition to a low carbon economy it will need EUR 200 billion of investment per year.¹

A Capital Markets Union should move the EU closer towards a situation where, for example, SMEs can raise financing as easily as large companies; costs of investing and access to investment products converge across the EU; obtaining finance through capital markets is increasingly straightforward; and seeking funding in another Member State is not impeded by unnecessary legal or supervisory barriers.

An action plan for a Capital Markets Union

Following the consultations that began in February, the Commission received over 700 responses. Feedback has been universally supportive of the importance of building a Capital Markets Union and the European Parliament² and the Council³ both confirmed strong support for taking a step-by-step approach, and that the issues identified in our consultation were the right ones on which to concentrate.

There is no single measure that will deliver a Capital Markets Union. Instead there will be a range of steps whose impact will cumulatively be significant. The Commission will take forward measures to remove the barriers which stand between investors’ money and investment opportunities, and overcome the obstacles which prevent businesses from reaching investors. The system for channelling those funds will be made as efficient as possible, both nationally and across borders.

As the closer integration of capital markets and gradual removal of remaining national barriers could create new risks to financial stability, we will support actions to increase supervisory convergence, so that capital market regulators act in a unified way and strengthen the available tools to manage systemic risks prudently. Based on the feedback and our own analysis, the Commission will take forward action in the following priority areas:

Providing more funding choices for Europe’s businesses and SMEs

Barriers to Europe’s business raising capital markets financing exist at every stage of the funding escalator and for public markets. These barriers limit smaller companies from raising equity and debt finance. The Commission will:

- Modernise the Prospectus Directive to make it less costly for businesses to raise funds publicly, review regulatory barriers to small firms listing on equity and debt markets and support the listing activities of small firms through European advisory structures;

¹ PRIMES, 2030 Impact Assessment.
² European Parliament resolution on Building a Capital Markets Union (2015/2634(RSP)).
³ Council of the EU conclusions on a Capital Markets Union of 19 June.
• Launch a package of measures to support venture capital and equity financing in the EU, including catalysing private investment using EU resources through pan-European funds-of-funds, regulatory reform, and the promotion of best practice on tax incentives;

• Promote innovative forms of business financing such as crowd-funding, private placement, and loan-orginating funds whilst safeguarding investor protection and financial stability; and

• Explore ways to build a pan-European approach to better connect SMEs with a range of funding sources.

Ensuring an appropriate regulatory environment for long term and sustainable investment and financing of Europe’s infrastructure

Europe requires significant volumes of new long term sustainable investment to maintain and increase competitiveness. Public support through measures such as the EUR 315 billion Investment Plan for Europe can help, but further measures are needed to unlock private investment for the longer term. The Commission will:

• Swiftly revise Solvency II calibrations to better reflect the true risk of infrastructure investment, followed by a review of the treatment under the Capital Requirements Regulation for bank exposures to infrastructure; and

• Assess the cumulative impact of previous regulatory reforms to ensure coherence and consistency, as part of the Commission’s initiative on Better Regulation and building on the work started in the European Parliament in 2013 on the coherence of EU financial services legislation.

Increasing investment and choices for retail and institutional investors

Retail savings held directly or indirectly through asset managers, life assurance companies and pension funds are key to unlocking capital markets. The consultation revealed that for retail investors saving for the future, greater investor confidence, transparency, certainty and choice can help to make the right investments. Europe’s asset management industry is generally working well, but more needs to be done to strengthen passporting and cross border competition. The Commission will:

• Look at ways to boost choice and competition in cross-border retail financial services and insurance through a Green Paper published later this year. It will also assess the regulatory framework for retail investment, looking particularly at improving transparency and the quality and availability of investment advice against the backdrop of increased on-line provision;

• Explore ways to increase choices for retirement saving and build an EU market for personal private pensions which pension providers could opt for when offering private pensions across the EU; and

• Deliver an effective European fund passport that eliminates cross-border fees and barriers to increase competition and consumer choice.

Enhancing the capacity of banks to lend

As lenders to a significant proportion of the economy and intermediaries in capital markets,
banks will play a central role in the CMU. Banks have strong local relationships and knowledge: bank lending will continue to be the main source of funding for many businesses alongside capital markets. The Commission will:

- Revitalise simple, transparent and standardised European securitisations to free up capacity on banks’ balance sheets and provide access to investment opportunities for long term investors;

- Explore the possibility for all Member States to benefit from local credit unions to operate outside the scope of the EU's capital requirements rules for banks;

- Assess whether and how to build a pan-European covered bond framework, building on national regimes that work well, and explore the feasibility of similar funding tools for SME loans.

**Bringing down cross-border barriers and developing capital markets for all 28 Member States**

Despite progress in recent decades to develop a single market for capital, there are still many obstacles that stand in the way of cross-border investment. These range from obstacles that have origins in national law, such as insolvency, tax and securities law, to obstacles arising from a fragmented market infrastructure. Therefore, we will:

- Consult on the key insolvency barriers and take forward a legislative initiative on business insolvency, addressing the most important barriers to the free flow of capital and building on national regimes that work well;

- Tackle uncertainty around securities ownership, and pursue improvements in the arrangements for clearing and settlement of cross-border securities transactions;

- Promote the development of capital markets in all 28 Member States, as part of the European Semester and by offering Member States tailored support to strengthen administrative capacity through the Commission’s Structural Reform Support Service;

- Work with the European Supervisory Authorities (ESAs) to develop and implement a strategy to strengthen supervisory convergence and identify areas where a more collective approach can improve the functioning of the single market for capital;

- Draw on the forthcoming European Systemic Risk Board (ESRB) review and international work, to ensure that national and European macro-prudential authorities have the tools to react appropriately to developments in capital markets.

This Action Plan sets out the building blocks for putting a well-functioning and integrated Capital Markets Union, encompassing all Member States, into place by 2019. This is a long term project but we will move quickly. The Commission will assess achievements and reassess priorities in 2017.

The direction to take is clear: to build a single market for capital from the bottom up, identifying barriers and knocking them down one by one, creating a sense of momentum, and sparking a growing confidence for investing in Europe's future. The free flow of capital was one of the fundamental principles on which the EU was built. More than 50 years on from the Treaty of Rome, let us seize this opportunity to turn that vision into reality.
1. THE PATH TO GROWTH – FINANCING FOR INNOVATION, START-UPS AND NON-LISTED COMPANIES

New start-up companies are critical to driving growth in the economy. Across the EU, small and medium-sized enterprises (SMEs) employ 2 in every 3 people and produce 58 cents in every euro of value-added. Entrepreneurs with promising business plans need to be able to secure financing to realise their ideas. Successful firms will need access to financing on attractive terms to fund their expansion. However, funding channels for growing firms seeking to raise equity capital or look for other forms of credit outside the banking system are underdeveloped in Europe. This is particularly the case for Europe’s SMEs, which receive more than 75% of their external finance from bank loans. A successful Capital Markets Union (CMU) should broaden the range of financing options for growing companies. These opportunities should exist and be available to entrepreneurs across all 28 EU Member States and across all stages of the ‘funding escalator’.

1.1. Financing the start-up phase

Banks’ strong local networks and relationships enable them to provide the majority of external financing for European SMEs. In recent years, to complement this, an increasing variety of non-bank financing options have also emerged to help companies. These range from money-lending and donor platforms, businesses trading their invoices, peer-to-peer lending, to investment-based crowdfunding or support from business angels.

Crowdfunding, for example, has been developing rapidly in some Member States. There are now more than 500 platforms providing a range of services in the EU. Given the predominantly local dimension of these activities, those Member States which are home to most crowdfunding activity are taking steps to clarify the conditions for this new business model. Securities-based crowdfunding platforms can be authorised under the Markets in Financial Instruments Directive (MiFID) and benefit from a passport to carry out regulated services and activities throughout the EU. Currently, there is no EU framework which specifically caters for lending-based crowdfunding. The EU should strike a careful balance between the objectives of investor protection and continued expansion of crowdfunding. Premature regulation could hamper, not foster, the growth of this fast-growing and innovative funding channel. The Commission set up a Crowdfunding Stakeholder Forum to support policy development in this area and launched a study to gather and analyse data on crowdfunding markets across the EU and assess the impact of national legislation. Building on existing work, the Commission will publish a report on the development of European crowdfunding.

The Commission will assess national regimes and best practice and monitor the evolution of the crowdfunding sector. Following this assessment, the Commission will decide on the best means to enable the development of this new funding channel across the Union.

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5 Estimation based on data from 22 EU Member States in 2014. Source: Crowdsurfer Ltd and Ernst & Young LLP, "Crowdfunding: Mapping EU markets and events study", 2015.
6 If the crowdfunding platform is authorised as an investment firm and complies with the relevant MiFID requirements.
Business angel investors are often experienced business people willing to offer financial and other support to start-ups. They have become an increasingly important source of equity capital at the seed and early stage of company formation. The amounts invested by European business angels remain small – EUR 357 million in 2013, of which more than half was concentrated in only 3 EU Member States (the United Kingdom, Spain and France). Europe needs a stronger network of business angels, capable of operating across EU borders. The Commission will continue to support cross-border networking and capacity building for business angels, with a particular focus on Central and Eastern Europe, to develop cross-border platforms, connecting business angels with innovative SMEs and facilitating match-funding.

1.2. The early expansion phase

Rapidly expanding firms, with high growth potential but limited working capital, may encounter funding gaps at critical moments in their expansion. Bank overdrafts or short term borrowing facilities alone often cannot meet these needs. Responses to the consultation identified expansion finance as the stage where the EU financial system underperforms the most. As these firms have the potential to grow into future large employers, the missed opportunities for the EU society can be very large.

Venture capital has a key part to play in supporting growth and offering entrepreneurs an option to raise funding in Europe as well as from overseas. Venture capital is typically long-term (equity) capital, channelled through funds which pool investor interest and diversify risk. However, EU venture capital funds remain relatively small. At around EUR 60 million, the average European venture capital fund is only half the size of that in the US, and around 90% of EU venture capital investment is concentrated in only 8 Member States. Public sector risk sharing can help to increase the scale of venture capital funds in Europe and the industry's footprint across all 28 Member States, as well as acting as a catalyst for private sector investment, helping to promote scale, diversification and geographical reach. The promotion of funds-of-funds could in particular help broaden private investment in venture capital by attracting institutional investors.

EU legislation has attempted to establish the regulatory conditions for a successful EU venture capital sector. The Regulation on European Venture Capital Funds (EuVECA) and the Regulation on European Social Entrepreneurship Fund (EuSEF) in particular define the conditions under which these funds can be marketed to institutional and high net worth individuals across the EU. However, the EuVECA and EuSEF passports are currently available only to smaller fund operators managing asset portfolios below EUR 500 million. Changes to these regulations could enhance the effectiveness of the passports by, for example,

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8 Not all of business angel investment is directly measurable. Some estimates consider that total angel investment might be greater than venture capital investment in some European countries with well-developed angel markets - see OECD (2011), Financing High-Growth Firms: The Role of Angel Investors.

9 Source: EBAN Statistics Compendium 2014. Data is available for 21 Member States.

10 Evidence from 15 OECD countries for 2001-11 shows that young businesses play a crucial role in employment creation. Young firms systematically create more jobs than they shed. In particular, young firms with fewer than 50 employees represent around 11% of employment and generally account for more than 33% of total job creation in the business sector, while their share in job losses is around 17%. (Source: OECD (2013), Science, Technology and Industry Scoreboard).


allowing larger fund managers to establish and market EuVECA and EuSEF funds, reducing the investment threshold in order to attract more investors and expediting cross-border marketing and investment.

Tax incentives can also be used to support equity financing, in particular for innovative companies and start-ups. The Commission will study how national tax incentives for venture capital and business angels can foster investment into SMEs and start-ups and promote best practice across Member States.

Complementing the financing provided to venture capital and SMEs under the Investment Plan, the Commission will take forward a comprehensive package of measures to support venture capital and risk capital financing in the EU. This will include amending the EuVECA and EuSEF legislation and proposals for a range of pan-European venture capital funds-of-funds and multi-country funds, supported by the EU budget to mobilise private capital. This comprehensive package will also include the promotion of best practices on tax incentives.

Public authorities can also support financial institutions in setting up business growth funds to promote SME equity. Sharing of best practice among Member States on how to set up business growth funds would extend the benefits of these schemes to a wider range of SMEs. The Commission will work with Member States and prudential supervisors to support the development of industry-led business growth funds to support equity in SMEs.

1.3. Supporting SMEs seeking finance

The information gap between SMEs and investors can be a hurdle to non-bank funding. In particular, search costs prevent potential investors from identifying and assessing attractive companies in which to invest. There is a need, on the one hand, to make small firms in need of financing better aware of the market-based funding options available to them and, on the other, to make firms more visible to prospective local and pan-European investors.

Signposting the availability of market-based funding options for SMEs through a range of Government-led and market-based means, is the first step. This communication could start by banks providing feedback to SMEs on the reasons for refusal to grant requested credit, which in some cases may be because there are more appropriate alternative funding options.

Advisory support is increasingly available through a number of private- and public-led schemes in some Member States. The Commission will facilitate an exchange of best practice to promote the availability of effective sources of information and support for SMEs seeking market-based funding in all Member States.

This local or national infrastructure for communicating about new funding opportunities could serve as a building block for an information system which connects prospective providers of external finance with SMEs seeking finance across Europe. Cross-border linkages could connect existing national systems to bring together investors and SMEs across Europe. A system linking national structures would preserve local level knowledge, important

14 The Commission's State Aid guidelines for risk finance clarify conditions under which Member States can set up schemes promoting venture capital, 2014/C 19/04.

15 As mandated by the latest Capital Requirements Regulation, Article 431 (4).

16 Examples include Aktiespararna (Sweden), Médiateur du Credit (France), Better Business Finance (UK), Investomierz (Poland), Industrie- und Handelskammern (Germany), amongst others.
in the SME sector, and allow SMEs to make available to investors at European level a set of core financial and credit data. A condition for such a system to add value would be sufficient comparability of key data, so that prospective investors across the EU have an accurate and reliable insight into the financial standing of SMEs. SME participation in this system and provision of any information would be on a voluntary basis. A recent mapping\textsuperscript{17} of SME credit information by the Commission revealed a high degree of diversity in the EU in terms of what information is shared, by whom, how it is shared and who has access to it. Standardisation of credit data will be facilitated by the new ECB AnaCredit database on corporate loans which comes on line in 2018.

The Commission will take forward a comprehensive strategy to overcome information barriers that prevent SMEs and prospective investors from identifying funding or investment opportunities through:

- working with European banking federations and business organisations to structure the feedback given by banks declining SME credit applications;
- working with the Enterprise Europe Network, to map existing local or national support and advisory capacities across the EU in order to promote best practices on assisting SMEs which could benefit from alternative funding options;
- building on work by the ECB and in Member States, investigate how to develop or support pan-European information systems that link up national systems to bring together finance-seeking SMEs and finance providers and take further action, as necessary.

1.4. Loan-originating funds

Large institutional investors or investment funds may invest in or directly originate loans (sometimes in partnership with banks) to mid-sized firms, thus providing a way to further diversify credit intermediation and increase financing opportunities. According to some estimates, as of the end of 2014, over 350 transactions were completed by 36 alternative lenders in just over two years. The volume of deals done by direct lending funds in Europe increased 43% between 2013 and 2014. There are now 40 active direct lending funds (up from 18 reported in 2012) and a further 81 new funds in the market looking to raise around EUR 70 billion.\textsuperscript{18} This could emerge as a potentially important future source of non-bank credit.

EuVECA and European Long Term Investment Funds (ELTIFs)\textsuperscript{19} can to a limited extent originate loans. Some Member States have also introduced bespoke regimes in their national legal frameworks to frame the conditions under which alternative investment funds can originate loans. This situation results in funds operating cross-border needing to comply with different requirements for their loan-origination activities. Clarification of the treatment of loan-originating funds in the regulatory framework could facilitate cross border development whilst ensuring they are regulated appropriately from an investor protection and financial stability perspective.

\textsuperscript{17} See European Financial Stability and Integration Report, April 2015, Chapter 7.

\textsuperscript{18} Source: AIMA, Financing the Economy: The role of alternative asset managers in the non-bank lending environment, May 2015.

\textsuperscript{19} Regulation on European Long-term Investment Funds, PE-CONS 97/14, 20.03.2015.
The Commission will work with Member States and the ESAs to assess the need for a coordinated approach to loan origination by funds and the case for a future EU framework.

1.5. Private placements

European companies increasingly express interest in using 'private placement' markets for raising capital (typically in excess of EUR 20 million) through issuance of debt instruments to institutional or other experienced investors. Due to the restricted number and type of investors, this funding channel triggers less onerous regulatory requirements. Private placements in Europe increased by approximately 30% in 2014 - from EUR 13 billion in 2013 to 17 billion in 2014. However, an even greater volume of funds was raised by European companies through private placement on US markets. European private placement is also limited to a small number of countries. Taken together, these considerations suggest that there is potential for this channel to develop further in Europe. The Commission has previously identified limited standardised processes and documentation as barriers to further development. The Commission is therefore fully supportive of the work by ICMA and the German Schuldscheine regime on these issues and will seek to draw on best practices and promote them across the EU through appropriate initiatives.

20 52% of the private placement deals, excluding those in the German Schuldscheine market, are listed. Source: S&P First European Private Placement League Table, 2015.
21 Source: S&P
22 In February 2015, ICMA published the Pan-European Corporate Private Placement Guide. This Guide promotes the use of standardised documentation produced by the Loan Market Association (governed by English law) and the Euro-PP Working Group (governed by French law). This initiative focuses solely on corporate debt.
23 For example, the German insurance industry, has developed a simple regime, acknowledged by BaFin, that allows insurers to easily calculate a predefined set of financial indicators to assess creditworthiness, as well as to assess compliance with the capital requirements for private placement investments.
2. MAKING IT EASIER FOR COMPANIES TO ENTER AND RAISE CAPITAL ON PUBLIC MARKETS

Public offers of debt or equity instruments are the principal funding route for mid-sized and large companies seeking to raise in excess of EUR 50 million. They offer access to the widest set of funding providers and provide an exit opportunity for private equity and business angels. Public markets are vital for the transition of high growth mid-sized companies to established global players. For instance, companies listed on the AIM market\textsuperscript{24} have shown on average a turnover growth of 37\% and an employment growth of 20\% in the year following the IPO.\textsuperscript{25} Efficient public markets are therefore a critical link in the finance chain.

While European public equity and debt markets have developed significantly in recent decades, they still lag behind other developed economies. Moreover, the picture is very mixed across EU Member States. This in part reflects the different size and funding needs of companies, as well as preferences for continued family ownership and control of corporations.\textsuperscript{26} The CMU consultation, however, also highlighted widespread concerns that the EU regulatory environment may not be conducive to further development of these funding channels. For example, the recent EU IPO Task Force report estimates the cost of listing fees alone in IPOs of deal size below EUR 6 million to be 10-15\% of the deal value. In comparison, for larger deals (EUR 50-100 million) these fees are about 5-8\%.\textsuperscript{27} At present, many SMEs consider these initial (and the ongoing) listing costs outweigh the benefits of going public.\textsuperscript{28} Reducing entry costs could allow more companies to raise capital on public markets.\textsuperscript{29}

The gateway to public markets for firms seeking funds is the prospectus. Prospectuses are legally required documents presenting all information about a company needed by investors to make informed decisions about whether to invest or not. Prospectus requirements have been harmonised to enable the comparison of investment opportunities across the EU. But they are costly and onerous to produce, particularly for SMEs, and typically run to hundreds of pages. For investors, they can be complex and excessively detailed, and the information which is critical for investment is hard to discern.

The Commission will modernise the Prospectus Directive\textsuperscript{30}. This will update when a prospectus is needed, streamline the information required and the approval process, and create a genuinely proportionate regime for SMEs to draw up a prospectus and access capital markets. The Commission will also explore how to support SMEs with the listing process through European advisory structures, such as, for example, the European Investment Advisory Hub.

\textsuperscript{24} An SME dedicated Multilateral Trading Facility (MTF) of the London Stock Exchange.
\textsuperscript{25} Improving the market performance of business information regarding SMEs, ECSIP Consortium 2013.
\textsuperscript{26} In 2009, family businesses made up more than 60\% of all European companies. Source: European Commission, Final Report of Expert Group – overview of Family-Business Relevant Issues: Research, Networks, Policy Measures and Existing Studies.
\textsuperscript{27} EU IPO Report issued by the European IPO Task Force (European Issuers, EVCA and FESE), 23 March 2015.
\textsuperscript{29} A recent Oxera study shows that the average cost for investors seeking information on an investment is USD 58 in the US versus EUR 430 in the EU.
\textsuperscript{30} As part of the Commission's REFIT programme for simplification and regulatory burden reduction.
Beyond the prospectus, there are a range of other challenges to raising capital publicly. SME Growth Markets, introduced by MiFID II, will from 2017 provide a stepping-stone for new companies to prepare for eventual listing on a larger exchange. The creation of this dedicated market may be particularly relevant for developing local markets or young issuers. To reap the full benefits of these dedicated platforms for the CMU, the Commission will ensure through the implementation of MiFID II that the requirements applying to them strike the right balance between providing sufficient investor protection and avoiding unnecessary administrative burden.

For investors, access to high growth SMEs on public market exchanges can be appealing due to potential returns and diversification benefits. Yet, they can be put off by poorer information sources and lower liquidity.\textsuperscript{31} Consultation responses highlighted a lack of research on SMEs by investor analysts\textsuperscript{32} and additional reporting requirements as two major challenges for SMEs trying to list on public market exchanges. Many SMEs admitted to trading on multilateral trading facilities (MTFs) report financial information only on the basis of national accounting standards, which may not be sufficient to meet the needs of international investors due to the lack of comparability. The Commission will also explore with the International Accounting Standards Board (IASB) the possibility of developing a voluntary tailor-made accounting solution, which could be used for companies admitted to trading on SME Growth Markets.

\textbf{The Commission will review the regulatory barriers to small firms for their admission to trading on public markets and work closely with the new SME Growth Markets under MiFID II to ensure that the regulatory environment for these incubator markets is fit for purpose.}

For larger firms, corporate bonds are a key mechanism for raising debt finance on a larger scale. Aided by historically low interest rates, total issuance by non-financial corporations of euro denominated corporate bonds nearly doubled between 2008 and 2014 to EUR 340 billion.\textsuperscript{33}

Despite record primary issuance, some market participants have raised concerns about the limited liquidity in secondary markets, which makes it difficult to trade in and out of these instruments. Limited liquidity could translate into higher illiquidity premiums and higher borrowing costs. If credit conditions were to deteriorate, some companies could quickly find it harder to access debt markets.

\textbf{The Commission will review the functioning of EU corporate bond markets, focusing on how market liquidity can be improved, the potential impact of regulatory reforms, market developments and voluntary standardisation of offer documentation.}

The creation of a consolidated tape for equities as of 2017 and for equity-like financial instruments as of 2018, as required by MiFID II, will make it easier for regulators and market


\textsuperscript{32} For example, the consultation response of APG stated that 50% of SMEs listed on Euronext Amsterdam, Brussels, Paris and Lisbon do not benefit from any financial research and 16% have only one analyst covering them.

\textsuperscript{33} Source: Bloomberg
participants to obtain a better view of the market, which should increase the attractiveness of the EU capital markets as investment destinations. The Commission will continue to monitor developments in this area.

Differences in the tax treatment of various financial instruments may impede efficient capital market financing. The preferential tax treatment of debt, resulting from the deductibility of interest rate payments, is at the expense of other financial instruments, in particular equity. Addressing this tax bias would encourage more equity investments and create a stronger equity base in companies. Also, there are obvious benefits in terms of financial stability, as companies with a stronger capital base would be less vulnerable to shocks. This is particularly true for banks.

As part of the broader work being taken forward on the Common Consolidated Corporate Tax Base (CCCTB), where a new proposal will be prepared in 2016, the Commission will examine ways to address debt-equity bias.
3. **INVESTING FOR THE LONG TERM, INFRASTRUCTURE AND SUSTAINABLE INVESTMENT**

Europe requires significant new long term and sustainable investment to maintain and extend its competitiveness and shift to a low-carbon and resource-efficient economy. The Capital Markets Union will support investors in taking well-informed investment decisions and monitoring relevant risks.

### 3.1. Improving the investment environment through the regulatory framework

The regulatory framework is a significant factor in the decision making of investors for long term investments in particular. Large institutional investors are natural providers of such funds. Insurance companies, pension funds and newly formed debt funds can benefit from the stable revenue streams from infrastructure debt that match longer-dated liabilities. Some banks are also active participants in infrastructure financing alongside national promotional banks.

Until recently, cross-border infrastructure investment has been hampered by the absence of commonly recognised vehicles for capital-raising and investing. The recently adopted European Long Term Investment Fund (ELTIF) Regulation, which will start applying from December 2015, creates a new cross-border fund vehicle for such long term projects (e.g., energy, transport and communication infrastructures; industrial and service facilities; and housing). The ELTIF Regulation combines the advantages of a cross-border passport with the possibility of raising long term capital from smaller investors (local pension plans, municipalities, corporate pension plans, etc.), including retail investors. The Regulation will give asset managers a new opportunity to provide investors with access to a far wider range of assets, including infrastructure, than was otherwise possible under the pre-existing regulatory framework. National tax treatments will be important for the take-up of ELTIFs, and the Commission urges Member States to grant them the same tax treatment as similar national schemes.

A critical regulatory issue concerns the absence of a distinct and suitably calibrated calculation of the regulatory capital that institutional investors should hold against infrastructure investments. The Commission will propose a definition of infrastructure investments that offers predictable long-term cash flows and whose risks can be properly identified, managed and monitored by insurers. This common definition will allow infrastructure to be treated as a dedicated asset class and enable adjustments to the regulatory framework, where justified.

Banks also remain important in providing or arranging loans for infrastructure projects. In July 2015 the Commission published a consultation paper on the potential impact of the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD IV) on bank lending to the economy which includes a review of banks’ capital requirements for long term and infrastructure finance. The objective is to gain a better understanding of the impact of the new rules on capital requirements on the availability of financing for infrastructure and other investments that support sustainable long-term growth.

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34 Managers authorised under AIFMD and domiciled in the EU can run these funds to invest in long term, illiquid or hard-to-sell assets such as infrastructure projects and SMEs that need stable financing for a number of years. In return, these assets are likely to pay an 'illiquidity premium', that is higher or more stable returns which make up for investors' inability to get their money before a predetermined date.

35 Regulation (EU) No 575/2013

36 Directive 2013/36/EU.
To facilitate the funding of infrastructure and sustainable long term investment in Europe, the Commission is presenting revised calibrations in Solvency II to ensure that insurance companies are subject to a regulatory treatment which better reflects the risk of infrastructure and ELTIF investments. The Commission will complete the review of the CRR and make changes on infrastructure calibrations, if appropriate.

3.2. Supporting long term and infrastructure financing

The scale of the crisis and the nature of the recovery have left a large infrastructure investment gap in the EU economy. The European Investment Bank (EIB) estimates that the total cumulative infrastructure investment needs in the EU could reach up to EUR 2 trillion for the period up to 2020.37

Institutional and other private investors can be an important source of funding for infrastructure investments as these investments can offer stable returns and a relatively strong credit performance history.38 There are signs that these investors are increasingly looking to invest in infrastructure projects. For the most ambitious, long-term and transformative projects, public intervention is often needed to kick start the process.39

Under the Investment Plan, the European Fund for Strategic Investments (EFSI) will mobilise EUR 315 billion of new, additional investments in the EU between 2015 and 2017 – of which EUR 240 billion will be directed towards infrastructure and innovation projects. A European Investment Project Portal will enable EU based project promoters to connect and share their investment projects and ideas with potential investors, and a European Investment Advisory Hub (EIAH) will offer a single point of entry for guidance and advice supporting infrastructure investments in the EU.

The new European Fund for Strategic Investments (EFSI), when possible together with European Structural and Investment Funds (ESI Funds), enables a variety of financing and risk-sharing options through the use of innovative financial instruments such as investment platforms or funds. The use of investment fund structures, including possibly in the form of ELTIFs which can raise capital from the retail investing public, or investment platforms under EFSI, can commingle public and private resources, and lead to better risk-return prospects.

For the EFSI, the Commission and the European Investment Bank (EIB) will provide guidance about the requirements for co-investment structures in order to be eligible for support by the Fund. Moreover, technical assistance will be available under the EIAH to investors that wish to explore the use of such structures. Beyond this, the Commission stands ready to work with private investors to support the pooling of private and EU resources in order to increase financing for infrastructure investments and sustainable growth.

38 A global study of default and recovery rates between 1983 and 2012 by Moody's shows that the 10-year cumulative default rate for the infrastructure sector is 6.6%. This is lower than for project finance bank loans. In addition, the recovery rate on defaulting infrastructure loans is also high (up to 80%).
39 For example in 2013, the total EU-28 public infrastructure investment was EUR 450 billion. Of this amount, public investments accounted for 90% and private investments (including public-private partnerships) accounted for roughly 10%, EIB Working Paper 2013/02, page 7.
3.3. Harnessing finance to deliver environmental sustainability

Efficient financial markets can help investors to make well informed investment decisions, and analyse and price long term risks and opportunities arising from the move towards a sustainable and climate friendly economy. This shift in investment can contribute towards delivering the 2030 climate and energy policy objectives and the EU's commitments on the Sustainable Development Goals. In particular, the recent emergence of Environmental, Social and Governance (ESG) bonds can help to direct capital towards sustainable investments: 2014 saw exponential growth in green bond issuance - EUR 35 billion compared to EUR 8 billion in 2013 and less than EUR 1 billion in 2012. The rapid growth in this market is being assisted by market-driven standardisation that takes into account project selection criteria developed by international financial institutions, such as the World Bank, the EIB and the European Bank for Reconstruction and Development (EBRD). Market participants are also developing voluntary guidelines, known as ‘Green Bond Principles’, to promote transparency and integrity in the development of the green bond market, and clarify qualification of issuance as a ‘green bond’. The Commission will continue to assess and support these and other developments in ESG investments, monitor the need for EU green bond standards, to help investors benefit from a more long term sustainable approach to investment decisions.

3.4. Call for evidence on existing regulatory framework

The EU has taken essential steps as part of an international consensus to restore financial stability and public confidence in the financial system. It is important that EU legislation strikes the right balance between reducing risk and enabling growth and does not create new barriers that were not intended. With this in mind, the Commission is launching a comprehensive review, in parallel with this Action Plan, of the cumulative impact and coherence of the financial legislation adopted in response to the financial crisis. The purpose of this review is to assess the overall coherence of the existing framework. Given the different pieces of legislation adopted over the past years and the numerous interactions between them, there is a risk that their collective impact may have some unintended consequences, which may not be picked up within individual sectoral reviews. Regulatory consistency, coherence and certainty are key factors for investor decision-making. If clear evidence is provided to justify specific and targeted changes, this could further help to improve the investor environment and meet the objectives of the CMU.

Building on the work of the European Parliament and international bodies, such as the Financial Stability Board and the Basel Committee on Banking Supervision, the Commission is today launching a call for evidence to evaluate the interactions between rules and the cumulative impact of the financial reform on the investment environment.
4. FOSTERING RETAIL AND INSTITUTIONAL INVESTMENT

The CMU aims to put European savings to better use, improving the efficiency through which savers and borrowers are matched, and increasing the economic performance of the EU economy.\(^{40}\) Greater investor confidence and certainty can help investors to make the right investment decisions. It is widely accepted that due to increasing life expectancy and changing demographics, retail investors need to save more to meet their retirement needs. Meanwhile, many institutional investors, operating in a low interest rate environment, cannot find sufficient investments that deliver the returns needed to meet their commitments.

4.1. Retail investors

Today, retail investors in Europe have significant savings in bank accounts, but are less directly involved in capital markets than in the past. Direct share ownership of European households has dropped from 28% in 1975 to 10-11% since 2007 \(^{41}\) and the proportion of retail investors among all shareholders is less than half the level it was in the 1970s. Removing the barriers to retail investors saving via the capital markets requires competitive financial markets that can offer choice to allow customers to compare products and find the most suitable savings vehicles at competitive prices. To further promote transparency in retail products, the Commission will ask the European Supervisory Authorities (ESAs) to work on the transparency of long term retail and pension products and an analysis of the actual net performance and fees, as set out in Article 9 of the ESA Regulations.

By the end of 2015, the Commission will publish a Green Paper on retail financial services and insurance that will seek views on how to increase choice, competition and the cross-border supply of retail financial products, as well as the impact of digitalisation on retail financial services.

As only occasional buyers of investment products, it is difficult for retail investors to build up relevant knowledge or experience in capital markets.\(^{42}\) While restoring the trust of retail investors in capital markets is primarily the responsibility of the finance industry, regulation and supervision can help to establish the 'rules of the game'.

Better information and advice are preconditions if retail investors are to be encouraged back into market-based financing. A first step is through transparency. Access to meaningful and high-quality information should be provided in a comparable and transparent manner across investment products – including on the key features of the products (e.g., costs, possible returns and risks). In recent years, the EU has made significant progress in improving disclosure requirements across all sectors. New disclosure requirements have been introduced through different legislative measures.\(^{43}\) Some of the detailed implementing rules are still in preparation and will progressively enter into force in the coming years. To ensure that recent legislative reforms fulfil their objectives, a comprehensive assessment of the effectiveness of


\(^{42}\) In 2013 only 35% of retail investors trusted investment services' providers to respect consumer protection rules. European Commission (2013), Market Monitoring Survey, 2010-2013.

this new disclosure landscape could help to ensure consistency, identify possible gaps or unnecessary duplications, and serve as a basis, where needed, for a streamlining of requirements.

To better mobilise savings channelled through capital markets, retail investors should also have easy access to a range of suitable and cost-effective investment products and affordable and independent advice. Some consultation responses underlined that retail investors currently receive limited rewards for assuming the higher risks associated with market-based investments because of large intermediation and distribution fees. Legislation in MiFID II, Packaged Retail and Insurance-based Investment Products (PRIIPs) and Insurance Distribution Directive (IDD) brings in important changes in the rules governing investment advice and product disclosure. The transition to online distribution of investment products and the emergence of new fintech solutions present an opportunity to develop further advisory services and "open access" online distribution platforms. It will be important to ensure these changes are accompanied by a critical assessment of the investment solutions and outcomes that are proposed to retail investors.

The Commission will undertake a comprehensive assessment of European markets for retail investment products, including distribution channels and investment advice, drawing on expert input. The assessment will identify ways to improve the policy framework and intermediation channels so that retail investors can access suitable products on cost-effective and fair terms. The assessment will examine how the policy framework should evolve to benefit from the new possibilities offered by online based services and fintech.

European households face a number of challenges to save efficiently towards adequate pensions in the context of increased longevity, fiscal pressures at individual country level and protracted low interest rates. To this end, the Commission is supporting the development of collective and individual pension plans to complement public pension schemes.

The EU financial system needs to support people in making provision for their own personal retirement savings. It can do this through policy measures aimed at incentivising and removing obstacles to the development of individual ('third pillar') pension plans in Europe.

At present, no effective single market for 'third pillar' personal pensions exists. A patchwork of rules at EU and national levels stands in the way of the full development of a large and competitive market for personal pensions. Market fragmentation prevents personal pension providers from maximising economies of scale, risk diversification and innovation, thereby reducing choice and increasing cost for pension savers. An 'opt in' European Personal Pension could provide a regulatory template, based on an appropriate level of consumer protection, that pension providers could elect to use when offering products across the EU. A larger, 'third pillar' European pension market would also support the supply of funds for institutional investors and investment into the real economy.

The Commission will assess the case for a policy framework to establish a successful European market for simple, efficient and competitive personal pensions, and determine whether EU legislation is required to underpin this market.

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45 An overview of the current market and regulatory framework is provided in EIOPA’s consultation paper on the creation of a standardised pan-European personal pension product of 3/7/2015.
4.2. Institutional investors

Institutional investors, in particular life insurance companies and pension funds, are natural long term investors. However, in recent years they have been retrenching from investment in long term projects and companies. The share ownership of insurers and pension funds dropped from more than 25% of the EU stock market capitalisation in 1992 to 8% at the end of 2012. At present, they typically hold a large share of their portfolio in a relatively narrow range of assets. The EU should support institutional investors to allow their exposure to long-term assets and SMEs, while maintaining sound and prudent asset-liability management.

Prudential regulation affects the appetite of institutional investors to invest in specific assets through the calibration of capital charges. The Commission will introduce more risk sensitive calibrations for infrastructure and ELTIFs (see Chapter 3) and for simple and transparent securitisation products (see Chapter 5). Beyond these measures, consultation feedback also highlighted the prudential treatment of private equity and privately placed debt in Solvency II as an impediment to investing in these asset classes.

The Commission will assess whether changes are warranted and, if so, prepare amendments which could be brought forward in the context of the Solvency II review.

Investment funds increased their share of ownership of EU stock markets from less than 10% in the 1990s to 21% in 2012. They have also become an increasingly important holder of corporate bonds in recent years. These funds are among the most active cross-border investors, but market fragmentation is still a prevalent issue in the European asset management sector. Many respondents to the consultation argued that a number of factors restrict cross-border activity of these funds, including discriminatory tax treatment, varying national requirements on the marketing of funds and fees for cross-border notifications. Eliminating unjustified barriers would incentivise fund managers to engage more in cross-border marketing of their funds and reduce costs for investors.

The Commission will gather evidence on the main barriers to the cross-border distribution of investment funds. This would include in particular disproportionate marketing requirements, fees, and other administrative arrangements imposed by host countries and the tax environment. Based on the evidence provided, the Commission will seek to eliminate key barriers, through legislative means if necessary.

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5. LEVERAGING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY

As lenders to a significant proportion of the economy and intermediaries in capital markets, banks will play an important role in the CMU and in the wider European economy. Banks have strong local relationships and knowledge that mean for many small businesses, bank lending will continue to be an important source of funding. For other firms, access to bank finance will remain important as part of their diversification of funding options. Therefore, in parallel to the work on the CMU, the Commission is reviewing the regulation of banks in order to ensure the optimal balance between managing risk and enabling growth.47

For smaller companies, strong local networks are important in supporting growth. Credit unions, in which for example SMEs can finance each other on a not-for-profit basis, operate in some Member States. They can also facilitate the exchange of know-how among members. The application of sophisticated and complex banking regulation may at times constitute a disproportionate obstacle to credit unions and other not-for-profit cooperatives serving SMEs. This may particularly be the case when they are small and focused principally on taking funds from and redistributing them among members, so that the risks for the wider financial system remain limited.

Credit Unions in certain Member States are already exempted from the CRD regulatory framework. To ensure a level playing field, all Member States should be able to benefit from credit unions, which are subject to national regulatory safeguards commensurate with the risks that they incur. To this end, the Commission will explore the possibility for all Member States to authorise credit unions which operate outside the EU’s capital requirements framework for banks.

Securitisation can increase the availability of credit and reduce the cost of funding. As a funding tool, securitisation can contribute to a well-diversified funding base. It can also act as an important risk-transfer tool to improve capital efficiency and allocate risk to match demand.

Following the crisis, EU securitisation markets remain significantly impaired, damaged by concerns surrounding the securitisation process and the risks involved. While these weaknesses manifested themselves primarily via securitisations based on US sub-prime loans48, the regulatory reform response that followed applied to all securitisations. There is no intention to undo EU reforms addressing the risks inherent in highly complex and opaque securitisations. However, it is important that securitisation is revived to ensure that it can act as an effective funding channel to the wider economy and mechanism to diversify risks. Under the Investment Plan, the Commission is already providing financial support to securitisation operations. New legislative proposals, adopted today, will go further. They will better differentiate simple, transparent and standardised (STS) products to support investor confidence and reduce due diligence burdens. Building on advice from the EBA, the Commission will also propose more appropriate prudential requirements for banks' and insurers' investments into STS products. This package of measures should help to free up capacity on banks' balance sheets and increase their ability to lend to the wider economy and contribute to building a more long term investor base.

48 At the height of the crisis, the worst-performing EU securitisation products rated AAA defaulted in 0.1% of the cases. In comparison, their US equivalent defaulted 16% of the times. Riskier (BBB-rated) EU securitisation also performed very well, with worst-performing classes defaulting in 0.2% of the cases at the height of the crisis. The default rate of BBB-rated US securities reached instead 62%. Source: EBA.
The Commission is publishing today a proposal for an EU framework for simple, transparent and standardised (STS) securitisation, together with new prudential calibrations for banks in CRR. Equivalent calibrations for insurers through an amendment to the Solvency II Delegated Act to incorporate the STS criteria will follow as soon as the STS framework has been adopted.

Covered bonds are another funding tool of particular importance in some Member States. However, the covered bond market is currently fragmented along national lines. The disparity between the legal frameworks and supervisory practices of the Member States that have enacted dedicated covered bond laws limit possibilities for market standardisation in underwriting and disclosure practices. This may result in obstacles to market depth, liquidity and investor access, in particular on a cross-border basis. An EU framework for a more integrated covered bond market could help reduce the cost of funding for banks issuing covered bonds, in particular in certain Member States.

The Commission is publishing today a consultation on the development of a pan-European framework for covered bonds, building on national regimes that work well without disrupting them and based on high-quality standards and best market practices. The consultation will also seek views on the use of similar structures to support SME loans.
6. FACILITATING CROSS-BORDER INVESTING

Despite significant progress in recent decades to develop a single market for capital, there are still many long-standing and deep-rooted obstacles that stand in the way of cross-border investments. These range from obstacles that have their origins in national law – insolvency, collateral and securities law – to obstacles in terms of market infrastructure, tax barriers and changes in the regulatory environment that undermine the predictability of rules for direct investments. Cross-border risk sharing within the EU has weakened since the start of the crisis and investment coming from outside the EU also declined over the same period.

Removal of some of the long-standing barriers which deter investors from diversifying their geographical portfolios would yield significant benefits to capital raisers, investors, and the EU economy as a whole. More integrated EU capital markets would also increase the attractiveness of the EU Member States as investment destinations for third country investors.

6.1. Legal certainty and market infrastructure for cross-border investing

Efficient and safe post-trade infrastructures are the key elements of well-functioning capital markets. One concern that featured prominently in the consultation responses is that securities ownership cannot currently be determined with legal certainty when the securities issuer and the investor are located in different Member States and/or securities are held by financial institutions in different Member States. These situations are increasingly common. Many respondents to the Green Paper called for provisions to clarify which national law applies to any given cross-border securities transaction. To this end, the Commission plans to enhance and broaden existing rules in the field. A modernisation of the law is even more important in view of the expected increase in cross-border securities transactions stimulated by the launch of Target2-Securities (T2S).

Moreover, differences in the national treatment of third party effects of assignment of debt claims complicates the use of these instruments as cross-border collateral and makes it difficult for investors to price the risk of debt investments. This legal uncertainty frustrates economically significant financial operations, such as securitisations which require robust collateral management.

The Commission will take forward early targeted work on uncertainty surrounding securities ownership. On the basis of further consultation and impact assessment, the Commission will also propose uniform rules to determine with legal certainty which national law shall apply to third party effects of the assignment of claims.

In recent years, EU legislation, such as European Markets Infrastructure Regulation (EMIR)\(^{50}\), Central Securities Depositories Regulation (CSDR)\(^{51}\) and MiFID II, has removed many of the barriers to the cross-border clearing and settlement of securities. However, with many provisions yet to enter into force and the recent establishment of the single settlement platform T2S, the post-trade landscape is undergoing significant changes. These changes are driving a restructuring of the post-trade infrastructure while encouraging innovative market practices, particularly in the area of collateral management. Markets need to be monitored to ensure that legislation keeps pace with these changing practices, while simultaneously ensuring that the safety and efficiency of the post-trading system is not diminished.

\(^{49}\) Where the original creditor transfers a debt claim to someone else.

\(^{50}\) Regulation (EU) No 648/2012.

Despite this progress, barriers remain to efficient cross-border clearing and settlement – including some of those identified by the Giovannini Report\(^{52}\) more than a decade ago. Many of these barriers have their origins in divergent national property and insolvency laws, as well as national laws regarding securities holdings which differ considerably in terms of the legal nature of the asset. These differences can give rise to uncertainty as to who owns a security in the event of a default and whose rights take precedence in the event of insolvency. However, uncertainty on such fundamental issues poses important legal risks, for example to the enforceability of collateral, and can threaten the resilience of cross-border settlement and collateral flows.

To support more efficient and resilient post-trading systems and collateral markets, the Commission will undertake a broader review on progress in removing Giovannini barriers to cross-border clearing and settlement, following the implementation of recent legislation and market infrastructure developments.

6.2. Removing national barriers to cross-border investment

Consistency in application, implementation and enforcement of the legal and supervisory framework is pivotal to the free movement of capital and the creation of a level playing field. Now that a significant number of EU financial provisions are in place to facilitate cross-border investment, the focus must move to effective implementation and enforcement. Barriers may have their origins in national legislation or administrative practice. Some relate to national "gold-plating" of EU minimum rules, while others may arise from divergent application of EU rules. Other barriers stem from national measures taken in areas where there is no EU legislation or where responsibility remains at national level.

For those barriers not addressed through other actions, including through supervisory convergence, the Commission will work with Member States to identify and dismantle them through a collaborative approach. The Commission will:

- set up a network of 28 national contact points and engage in bilateral discussions on the potential for national action to lift barriers;
- develop best practice, scorecards, recommendations and guidelines based on the work within the network.

The Commission, working with Member States, will map and work to resolve unjustified national barriers to the free movement of capital, stemming, amongst other things, from insufficient implementation or lack of convergence in interpretation of the single rulebook and from national law that are preventing a well-functioning Capital Markets Union and publish a report by the end of 2016.

Convergence of insolvency and restructuring proceedings would facilitate greater legal certainty for cross-border investors and encourage the timely restructuring of viable companies in financial distress. Consultation respondents broadly agreed that both the inefficiency and divergence of insolvency laws make it harder for investors to assess credit risk, particularly in cross-border investments.

The 2015 World Bank Doing Business Report ranks countries on the strength of their insolvency frameworks on a scale of 0-16. The EU simple average is 11.6, which is 5% below the OECD average for high income countries (12.2). Some Member States score below 8.

In 2014 the Commission published a Recommendation\(^{53}\) on a new approach to business failure and insolvency which encourages Member States to implement early restructuring procedures and give a "second chance" to entrepreneurs. The Recommendation sets out common principles for national insolvency procedures for businesses in difficulties as well as measures aimed at reducing the length and costs of proceedings for SMEs (e.g. use of standard forms, use of distance means of communication). While it is clear that the Recommendation has provided a useful focus for those Member States undertaking reforms in the area of insolvency, an assessment undertaken by the Commission shows that it has only been implemented partially, including in those Member States that have launched reforms.\(^{54}\)

The Commission will propose a legislative initiative on business insolvency, including early restructuring and second chance, drawing on the experience of the Recommendation. The initiative will seek to address the most important barriers to the free flow of capital, building on national regimes that work well.

Tax is also an issue of high importance for cross-border investment decision making. Two particular tax barriers to cross-border investment have been identified as particularly relevant in the context of the CMU. First, many investors underlined that they are currently penalised when investing cross-border by the application of local withholding taxes which are near impossible to reclaim, in addition to their domestic tax. The problem stems from different national approaches in the application of withholding taxes and the complexity of procedures to claim relief from these taxes. The potential discriminatory taxation of pension funds and life insurance companies is also a barrier to cross-border investment.

To encourage Member States to adopt systems of relief-at-source from withholding taxes and to establish quick and standardised refund procedures, the Commission will promote best practice and develop a code of conduct with Member States on withholding tax relief principles. The Commission will also undertake a study on discriminatory tax obstacles to cross-border investment by life insurance companies and by pension funds and, where necessary, will initiate infringement procedures.

Currently, there are around 200 bilateral investment treaties between Member States ("intra-EU BITs") which set varying standards of treatment for cross-border investment within the single market and are incompatible with EU law. The Commission has recently taken legal action against these intra-EU BITs. The Commission will work with Member States to explore whether additional action is needed to further strengthen safeguards for cross-border investors and in doing so to reinforce the attractiveness of the single market as an investment destination.

\(^{53}\) C(2014) 1500 final, 12.3.2014.

\(^{54}\) Evaluation of the implementation of the Recommendation on a new approach to business failure and insolvency (http://ec.europa.eu/justice/civil/commercial/insolvency/index_en.htm)
6.3. Promoting financial stability and supervisory convergence

By promoting more diverse funding channels CMU will help to increase the resilience of the EU financial system. At the same time, there is a need to be alert to financial stability risks emerging in capital markets. In recent years, the EU has put in place a range of reforms to make capital markets more transparent, well regulated and robust, including reducing risks in derivative markets through EMIR, introducing safer and more transparent trading rules in MiFID and ensuring all alternative fund managers in the EU are regulated through the AIFMD. Further reforms are in train through the Securities Financing Transactions Regulation (SFTR), the proposal on Money Market Funds and the forthcoming legislative proposal on CCP recovery and resolution. The FSB is prioritising work to understand and address vulnerabilities related to entities undertaking bank-like activities on capital markets. Ensuring a global regulatory approach to potential emerging systemic risks will both support financial stability and facilitate cross-border investment.

The Commission will work with the FSB and ESAs alongside the European Systemic Risk Board (ESRB) to assess possible risks to financial stability arising from market-based finance. Further analytical work will be conducted, for example to better understand the issues of market liquidity and interconnectedness in the financial system, and to assess if additional macro-prudential instruments should be developed. The Commission will make any changes necessary to the macro-prudential framework in the context of the forthcoming ESRB review.

With respect to supervision, feedback to the consultation was positive on the architecture that the EU put into place following the financial crisis in 2011. While progress has been made in establishing the European System of Financial Supervision and putting in place the single rule book, consultation respondents also emphasised the importance of ensuring supervisory convergence and consistent implementation and application of EU financial services legislation - an issue also highlighted in the Five Presidents' Report on Completing Europe's Economic and Monetary Union.

Capital markets legislation adopted in recent years confers an important role on the ESAs in a number of areas. Consultation feedback called on ESMA in particular to play a stronger role in enhancing supervisory convergence in capital market regulation and market reporting, and ensure that the single rulebook is consistently applied across the EU. Efforts in recent years to build a single rulebook for capital markets should lead to more integrated and efficient capital markets. Deeper financial integration will need to be accompanied by increased focus by ESMA on achieving convergence of supervisory outcomes across the EU, including on accounting, to ensure that the single market works well. ESMA could focus more on identifying, supporting and promoting best practice to ensure the effectiveness of the supervisory techniques of Member States and comparable outcomes throughout the EU. In this context, ESMA should make more systematic and efficient use of the tools it has, in particular thematic and country peer reviews.

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55 Speech of V. Constâncio, Vice President of the ECB.
56 As set out in the SFTR, following the outcome of the work performed by relevant international fora and with the assistance of ESMA, EBA and the ESRB, the Commission will report to the European Parliament and the Council in 2017 on progress in international efforts to mitigate the risks associated with SFTs, including on the FSB recommendations for haircuts on non-centrally cleared SFTs and their appropriateness for European markets.
The Commission will work with ESMA to develop and implement a strategy to strengthen supervisory convergence and to identify areas where a more integrated approach can improve the functioning of the single market for capital. The Commission will also work with ESMA to enhance the effectiveness of its thematic and country peer review decision-making. The Commission will publish a White Paper in 2016 on the governance and the financing of the ESAs.

The CMU is a classic single market project for the benefit of all 28 Member States. To help capital markets deliver their full potential, the Commission will, through the Structural Reform Support Service, develop a strategy for providing technical assistance to Member States where needed to reinforce specific capacities of national capital markets.

6.4. Facilitating international investment

For EU capital markets to thrive, they will need to be open and globally competitive, and able to attract additional equity and debt investment from international investors. CMU will help to make EU capital markets more attractive to international investors by eliminating legal and administrative cost to cross-border operations, and enhancing convergence of supervisory outcomes across Europe. Given the global nature of capital markets, Capital Markets Union must take account of the wider global context and ensure that European capital markets remain an integral part of the international financial system. The Commission will continue to work closely with EU Member States and third countries in international fora such as the FSB and IOSCO to develop convergent policy responses in order to support the development of global capital markets. In addition, the Commission will seek to establish frameworks for regulatory cooperation in financial services with key third countries to strengthen integration of capital markets.

The EU’s international trade and investment policy has an important role to play in supporting international investment. International trade and investment agreements liberalise the movement of capital, regulate market access and investment, including for the supply of financial services, and can help to achieve an appropriate level of protection and a level playing field for investors. The Commission will also continue to contribute to international work on the free movement of capital, including in the context of the OECD Codes of Liberalisation of Capital Movements.
7. **NEXT STEPS AND MONITORING**

This Action Plan set out the priority actions needed to encourage investment in all Member States and across the EU, and better link savings with growth. The preparation of the proposed actions will be subject to appropriate consultation and impact assessment of the range of options for achieving the objectives.

The successful adoption and implementation of these actions will require a sustained and concerted effort. This is a project for all 28 Member States and the Commission will work closely with them and the European Parliament to take forward these proposals.

To build early momentum, concrete proposals are being announced today and others will soon follow. First actions include a comprehensive package on securitisation with updated calibrations for CRR, the definition of infrastructure and revised calibrations for Solvency II, and a proposal to review the Prospectus Directive. In other areas, further consultation with interested parties may be needed. In parallel, the Commission will facilitate discussions with Member States on items such as tax and insolvency to enable progress to be reached over the medium to long term.

The success of the CMU will also depend on market participants. Financial intermediaries must play their part in restoring the trust of their clients and building confidence in capital markets in Europe. This Action Plan includes market-led initiatives and the Commission urges the relevant parties to prioritise progress in these areas.

Furthermore, the Commission will continue to work to identify the main inefficiencies and barriers to deeper capital markets in Europe and work out how best to overcome them, whilst retaining a strong focus on investor protection and market supervision.

In addition to annual reports, the Commission will prepare a comprehensive stock-take in 2017 as a basis for deciding on any additional measures that may be required.

The Commission will report regularly to the European Parliament and Member States on progress.
### Annex 1: List of actions and indicative timeline

<table>
<thead>
<tr>
<th>Financing for innovation, start-ups and non-listed companies</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Support venture capital and equity financing</strong></td>
<td></td>
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<tr>
<td>Proposal for pan-European venture capital fund-of-funds and multi-country funds</td>
<td>Q2 2016</td>
</tr>
<tr>
<td>Revise EuVECA and EuSEF legislation</td>
<td>Q3 2016</td>
</tr>
<tr>
<td>Study on tax incentives for venture capital and business angels</td>
<td>2017</td>
</tr>
<tr>
<td><strong>Overcome information barriers to SME investment</strong></td>
<td></td>
</tr>
<tr>
<td>Strengthen feedback given by banks declining SME credit applications</td>
<td>Q2 2016</td>
</tr>
<tr>
<td>Map out existing local or national support and advisory capacities across the EU to promote best practices</td>
<td>2017</td>
</tr>
<tr>
<td>Investigate how to develop or support pan-European information systems</td>
<td>2017</td>
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<tr>
<td><strong>Promote innovative forms of corporate financing</strong></td>
<td></td>
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<tr>
<td>Report on crowdfunding</td>
<td>Q1 2016</td>
</tr>
<tr>
<td>Develop a coordinated approach to loan origination by funds and assess the case for a future EU framework</td>
<td>Q4 2016</td>
</tr>
<tr>
<td><strong>Making it easier for companies to enter and raise capital on public markets</strong></td>
<td></td>
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<tr>
<td><strong>Strengthen access to public markets</strong></td>
<td></td>
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<tr>
<td>Proposal to modernise the Prospectus Directive</td>
<td>Q4 2015</td>
</tr>
<tr>
<td>Review regulatory barriers to SME admission on public markets and SME Growth Markets</td>
<td>2017</td>
</tr>
<tr>
<td>Review EU corporate bond markets, focusing on how market liquidity can be improved</td>
<td>2017</td>
</tr>
<tr>
<td><strong>Support equity financing</strong></td>
<td></td>
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<tr>
<td>Address the debt-equity bias, as part of the legislative proposal on Common Consolidated Corporate Tax Base</td>
<td>Q4 2016</td>
</tr>
<tr>
<td><strong>Investing for long term, infrastructure and sustainable investment</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Support infrastructure investment</strong></td>
<td></td>
</tr>
<tr>
<td>Adjust Solvency II calibrations for insurers' investment in infrastructure and European Long Term Investment Funds</td>
<td>Q3 2015</td>
</tr>
<tr>
<td>Review of the CRR for banks, making changes on infrastructure calibrations, if appropriate</td>
<td>Ongoing</td>
</tr>
<tr>
<td><strong>Ensure consistency of EU financial services rulebook</strong></td>
<td></td>
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<tr>
<td>Call for evidence on the cumulative impact of the financial reform</td>
<td>Q3 2015</td>
</tr>
<tr>
<td><strong>Fostering retail and institutional investment</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Increase choice and competition for retail</strong></td>
<td></td>
</tr>
<tr>
<td>Green Paper on retail financial services and insurance</td>
<td>Q4 2015</td>
</tr>
<tr>
<td><strong>Help retail investors to get a better deal</strong></td>
<td></td>
</tr>
<tr>
<td>EU retail investment product markets assessment</td>
<td>2018</td>
</tr>
<tr>
<td>Category</td>
<td>Description</td>
</tr>
<tr>
<td>------------------------------------------------------------------------</td>
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</tr>
<tr>
<td>Support saving for retirement</td>
<td>Assessment of the case for a policy framework to establish European personal pensions</td>
</tr>
<tr>
<td>Expand opportunities for institutional investors and fund managers</td>
<td>Assessment of the prudential treatment of private equity and privately placed debt in Solvency II Consultation on the main barriers to the cross-border distribution of investment funds</td>
</tr>
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</tr>
<tr>
<td><strong>Leveraging banking capacity to support the wider economy</strong></td>
<td></td>
</tr>
<tr>
<td>Strengthen local financing networks</td>
<td>Explore the possibility for all Member States to authorise credit unions outside the EU’s capital requirements rules for banks</td>
</tr>
<tr>
<td>Build EU securitisation markets</td>
<td>Proposal on simple, transparent and standardised (STS) securitisations and revision of the capital calibrations for banks</td>
</tr>
<tr>
<td>Support bank financing of the wider economy</td>
<td>Consultation on an EU-wide framework for covered bonds and similar structures for SME loans</td>
</tr>
<tr>
<td><strong>Facilitating cross-border investing</strong></td>
<td></td>
</tr>
<tr>
<td>Remove national barriers to cross-border investment</td>
<td>Report on national barriers to the free movement of capital</td>
</tr>
<tr>
<td>Improve market infrastructure for cross-border investing</td>
<td>Targeted action on securities ownership rules and third-party effects of assignment of claims Review progress in removing remaining Giovannini barriers</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Foster convergence of insolvency proceedings</td>
<td>Legislative initiative on business insolvency, addressing the most important barriers to the free flow of capital</td>
</tr>
<tr>
<td>Remove cross-border tax barriers</td>
<td>Best practice and code of conduct for relief-at-source from withholding taxes procedures Study on discriminatory tax obstacles to cross-border investment by pension funds and life insurers</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Strengthen supervisory convergence and capital market capacity building</td>
<td>Strategy on supervisory convergence to improve the functioning of the single market for capital White Paper on ESAs' funding and governance Develop a strategy for providing technical assistance to Member States to support capital markets' capacity</td>
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<td></td>
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<tr>
<td>Enhance capacity to preserve financial stability</td>
<td>Review of the EU macroprudential framework</td>
</tr>
</tbody>
</table>
Many thanks for your message.

I am very grateful that you have accepted our invitation to address our RPC Committee on 11 June.

My colleague [redacted], RPC Secretary and I will be in touch with your office to finalise the organisation of your participation.

With best regards,

On behalf of [redacted], I would like to thank you for inviting her to address the ICMA RPC on 11 June at 11 am in Paris. I have the pleasure informing you, that [redacted] is available and would be happy to discuss ESMA’s recent activities with the Committee.

I will block the slot in [redacted] diary and am looking forward to hearing from you closer to the date with more details and the venue.

Please also note, that [redacted] and I took over as [redacted] Assistant.

Kind regards

Sent: 13 March 2015 13:43
It remains my pleasure to be a member of ESMA’s Securities and Markets Stakeholder Group (SMSG) and I am enjoying being able to personally contribute to the SMSG’s opinions and advice to ESMA during the ongoing critical phase of the upgrading of financial regulation and supervision.

As [insert], I also remain keen to continue to ensure an effective and fruitful dialogue between ESMA and ICMA, the mutual benefit of which should be greater than ever given the extent of the work ESMA is currently called to perform in those areas of the capital market which fall under ICMA’s purview.

In this context, notwithstanding that we recognise that you already have a very busy agenda, on behalf of the members of ICMA’s Regulatory Policy Committee (RPC), we would be most pleased if you were once again able to accept our invitation to address the ICMA RPC, the next meeting of which is being arranged to take place on 11 June. If you are available to accept this invitation we will arrange for the meeting to be held in Paris and would anticipate starting at 11 am (CET). Should this not be possible for you we would be interested to explore alternative dates or times.

As you will recall, the ICMA RPC comprises a mix of the government affairs, regulatory and compliance heads in member firms, together with the chairs of various ICMA market practices committees; and oversees all ICMA’s regulatory policy and market practices work. Particularly in the context of ESMA’s work on MiFIR/MiFID and CSDR, but also other ongoing regulatory files, they would be very interested to hear an update (say 20 - 30 minutes) on ESMA’s latest work. There would then be the opportunity to conduct a mutually beneficial exchange of views in an open discussion with the ICMA RPC, such that we would anticipate the full session lasting for one hour.


Best regards to you as well as to [insert] and your colleagues
Sent from my iPad

Begin forwarded message:

From:
Subject: MiFID II - COMM non-papers

Dear All,
Commission services non-paper (04/02/2015)

MIFID II – main issues in relation to the preparation of Commission Delegated Acts

Safeguarding of client assets / The inappropriate use of title transfer collateral arrangements (TTCA) for non-retail clients

Disclaimer: The information contained in this document has been prepared by the services of DG FISMA and is intended only for discussion purposes at the EGESC meeting. It does not purport to represent or prejudge the Commission's final position. The Commission intends to conduct this exercise taking into consideration the need to achieve the objectives of encouraging growth, maintaining effective investor protection and promoting financial stability. An impact assessment will accompany the relevant delegated acts, being mindful of the cumulative effect and the need to avoid unintended consequences. We would therefore welcome suggestions to this end.

1. Introduction

Article 16(8) and 16(9) of MiFID II aim at protecting investor’s ownership and other similar rights in respect of securities and the investor’s rights in respect of funds entrusted to a firm. Article 16(8) requires an investment firm, “when holding financial instruments belonging to clients, make adequate arrangements so as to safeguard the ownership rights of clients, especially in the event of the investment firm’s insolvency, and to prevent the use of a client’s financial instruments on own account except with the client’s express consent”. Similarly, Article 16(9) requires the investment firm holding funds belonging to clients to “make adequate arrangements to safeguard the rights of clients and, except in the case of credit institutions, prevent the use of client funds for its own account”. The Commission is empowered to adopt delegated acts to specify the concrete organisational requirements laid down in these paragraphs.

Recital 52 reminds that “the requirements concerning the protection of client assets are a crucial tool for the protection of clients in the provision of services and activities. Those requirements can be excluded when full ownership of funds and financial instrument is transferred to an investment firm to cover any present or future, actual or contingent or prospective obligations. That broad possibility may create uncertainty and jeopardise the effectiveness of the requirements concerning the safeguard of client assets. Thus, at least when retail client assets are involved, it is appropriate to limit the possibility of investment firms to conclude title transfer financial collateral arrangements as defined under Directive 2002/47/EC of the European Parliament and of the Council (24), for the purpose of securing or otherwise covering their obligations” (our underlining).
2. **ESMA's technical advice**

ESMA’s technical advice specifies the arrangements that firms should have in order to ensure the safeguarding of client assets in accordance with Articles 16(8) and 16(9) of MiFID II. In particular, ESMA’s technical advice states that investment firms should not conclude title transfer collateral arrangement [TTCA] with non-retail clients without proper consideration:

“Investment firms shall consider and be able to demonstrate that they have properly considered the use of TTCA in the context of the relationship between the client’s obligation to the firm and the client assets subjected to TTCA by the firm” (para 5 of ESMA technical advice/page 75).

The ESMA technical advice (para 4) also explains that “TTCA are not appropriate where:

i. there is only a very weak connection between the client’s obligation to the firm and the use of TTCA, including where the likelihood of a liability arising is low or negligible;

ii. the amount of client funds or financial instruments subject to TTCA far exceeds the client’s obligation, or is even unlimited if the client has any obligation at all to the firm; or

iii. firms insist that all clients’ assets must be subject to TTCA, without considering what obligation each client has to the firm”.

Furthermore, the ESMA's technical advice foresees specific risk disclosures in order for clients to make informed decisions on whether to proceed with a transaction or not: “Where using TTCA, investment firms shall highlight to clients the risks involved and the effect of any TTCA on the client’s assets”.

3. **Preliminary assessment and suggested way forward**

Safekeeping rules are designed to mitigate risks related to cases where ownership of assets has been in dispute (such as the Lehman Brothers case) and to ensure appropriate arrangements in the area of safeguarding client assets.

MiFID II rules (16(8) and (9)) require investment firms to make arrangements for the protection of client ownership rights. The MiFID II safeguarding rules are however excluded when investment firms conclude TTCA with their clients whereby the firm takes ownership of client’s for the purpose of securing or otherwise covering present or future, actual, contingent or prospective obligations.

Two essential elements guiding the ESMA’s technical advice are i) the fact that once concluded TTCA undermine the MiFID II protections and jeopardise the effectiveness of segregation of client assets requirements and that ii) such arrangements serve the purpose of
securing or covering client’s present or future, actual or contingent or prospective obligations.

ESMA’s technical advice on the inappropriate use of TTCA with non-retail clients does not introduce (unlike for retail clients for which Article 16(10) of MiFID II banned TTCA) a prohibition on firms to conclude TTCA with non-retail clients. The technical advice only requires an investment firm to consider, prior to its conclusion and “in order to protect an investor’s ownership and other similar rights in respect of securities and the investor’s rights in respect of funds entrusted to a firm” (recital 51, MiFID II), the appropriateness of TTCA in light of circumstances set out in in para 4 (i)-(iii) of the ESMA technical advice and be able to demonstrate the appropriateness of TTCA used with its clients by means of the relationship between the client’s obligation to the firm and the client assets subjected to TTCA by the firm.

Proper consideration of TTCA is a preventive measure and aims to deter poor practices. The ESMA’s technical advice solely requires firms to consider the usage of such agreements and to have appropriate records and documentation. The rationale of this approach is to avoid firms use TTCA for general and wide-ranging purposes without any relation with the client’s liability and therefore disapply the MiFID II segregation rules.

Should firms enter into TTCA without proper consideration of the client’s liability this would mean that they would act contrary to the best interests of the client by taking ownership of more than would be necessary in light of the client’s liability towards the firm.

Firms are required to act honestly, fairly and professionally in accordance with the best interests of their clients when using TTCA, particularly in light of the effect of these arrangements on firms' obligations under MiFID II and their duties towards investors. Also, Article 16(3) of MiFID II requires investment firms to maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from adversely affecting the interests of its clients. Such a conflict would be likely to appear in cases where firms would use in an inappropriate manner its client’s assets, without properly considering whether the assets subject to TTCA are for the purpose of securing or otherwise covering present or future, actual, contingent or prospective obligations.

Consequently, an investment firm should operate effective organisational and administrative arrangements to ensure that it only disappplies the protection that it normally owes to its clients when necessary to cover client’s obligations. It is essential that firms are able to demonstrate that they do not take ownership of clients’ assets without due consideration of the link between client’s debt and use of TTCA. Firms should therefore have a documented process of their use of title transfer collateral arrangements (TTCA).

1 See definition of TTCA under the Financial Collateral Directive, Article 2(1)(b).
Question: Is further clarification needed in order to confirm that the ESMA's technical advice does not intend to prohibit TTCA with non-retail clients?

Accordingly, for the purposes of ensuring clients’ best interests and safeguarding clients’ rights in relation to financial instruments and funds belonging to them, investment firms shall consider and be able to demonstrate that they have properly considered the use of TTCA in the context of the relationship between the client’s obligation to the firm and the client assets subjected to TTCA by the firm. When considering, and documenting, the appropriateness of the use of TTCA, investment firms shall take into account the following factors:

i. whether there is only a very weak connection between the client’s obligation to the firm and the use of TTCAs, including whether the likelihood of a liability arising is low or negligible;

ii. whether the amount of client funds or financial instruments subject to TTCAs far exceeds the client’s obligation, or is even unlimited if the client has any obligation at all to the firm; or

iii. whether all clients’ assets are made subject to TTCAs, without consideration of what obligation each client has to the firm.

At last, it can be noted that the approach put forward by ESMA in its technical advice appears to converge with international workstreams, in particular with the FSB recommendation 72: “In jurisdictions where client assets may be re-hypothecated for the purpose of financing client long positions and covering short positions, they should not be re-hypothecated for the purpose of financing the own-account activities of the intermediary”.

Question: does ESMA's technical advice and suggested drafting clarifications provide the necessary guidance to mitigate the risk of blanket use of TTCA that amounts to bypassing the safeguarding requirements required by MiFID II?

Introduction

MiFID II requirements apply to a broad range of commodity derivatives. In particular recitals 8, 9 and 10 of MiFID II express the desire to make clear that commodity derivatives and others which are constituted and traded in a similar way to traditional financial instruments should be subject to the requirements of MiFID II. Nevertheless, MiFID II acknowledges that certain contracts which are subject to other EU regulations, in particular under Regulation (EU) No 1227/2011 on wholesale energy market integrity and transparency (REMIT), should not be covered by the definitions of Financial Instruments. MiFID II includes specific empowerments for delegated acts to further specify some of these elements.

This non-paper seeks Member views on ESMA's technical advice.

Specifying Section C6 of Annex I

2.1. C6 Summary of ESMA's technical advice

Section C6 defines financial instruments as “Options, futures, swaps, and any other derivative contracts relating to commodities that can be physically settled provided they are traded on a RM, a MTF or an OTF, except for wholesale energy products traded on an OTF that must be physically settled”; ESMA's technical advice relates to the exemption taking into account Recital 10 of MiFID II which requires that the limitation of scope should be ‘limited to avoid a loophole which may lead to regulatory arbitrage’.

ESMA’s technical advice was framed by Recital 10 which also requires a limitation of this exemption, by “the creation of an enforceable and binding obligation to physically deliver, which cannot be unwound and with no right to cash settle or offset transactions except in the case of force majeure, default or other bona fide inability to perform”.

In order to specify these contracts, ESMA focused on the provisions of the contracts which must be unconditional, unrestricted and enforceable and should not allow cash settlement or other forms of netting. This found broad approval; however three specific areas deserve special attention:

- **Proportionate Arrangements to make or take delivery**: ESMA determined that for contracts which ‘must be physically settled’, it was necessary that parties to the contracts had the necessary proportionate arrangements in place to make or take the
delivery of gas or power. This requires that parties to the contract have arrangements in place which are adequate considering, for example, the size of their commercial activities or production, storage or consumption capabilities.

- **Operational netting:** ESMA opined, that subject to having all the provisions in place for a physical contracts (enforceable obligation, no netting, physical arrangements in place...), operational netting under the rules of transmission system operators (TSO) should not prevent a contract from being physically settled.

- **Termination clauses (force majeure, bona fide inability to perform).** In line with recital 10, ESMA considered that bona fide termination clauses do not prevent a contract from being physically settled. ESMA has defined these terms and types of clauses narrowly but in abstract manner in order to cater for all circumstances.

### 2.2. C6 Discussion

ESMA’s technical advice on the specification for C6 instruments sought to strike a balance between avoiding regulatory loopholes and by allowing certain exemptions for instruments covered by REMIT. The focus on the provisions of the contract (rather than intent) allows for legal certainty; and the narrow framing of force majeure/bona fide inability clauses is in line with the intent of the co-legislators. ESMA also sought to avoid unintended effects on energy markets by allowing operational netting; but was careful to limit this netting to cases prescribed by TSOs.

One key aspect of ESMA’s technical advice is the requirement that parties to contracts sign up to provisions which ensure they have proportionate arrangements in place to make or take delivery of the underlying commodity. These provisions should ensure that only contracts which are genuinely for physical delivery benefit from the exemption and follow clearly from recital 10.

There is nevertheless a risk that the current wording could be interpreted in different ways and hence the exemption might be applied in differently across the Union. For instance, the draft does not specify whether participants should have storage/delivery/production capacities; and in which proportion to the notional amounts traded in the contract. One extreme interpretation of the provisions would be require parties to a contracts to have the capacity to take or make delivery for the entirety (100%) of the notional amount of the physical contract. Other interpretations of the text would imply that only a fraction of the notional amount is needed in order to be in compliance with rules. A quantitative measurement of the participants’ physical arrangements might create legal certainty; however it is unlikely that one single threshold could be applicable across the Union given the different size and nature of markets. Nonetheless, specifying a quantitative threshold would create practical implementation issues: the party wishing to use the exemption should monitor his capacity net of other obligations before each transaction.

Furthermore the technical advice does not make clear that participants should have capacity for each type of commodity traded (i.e. the capacity should not be fungible across asset classes) or that they should have the necessary licenses to operate.

Is additional specification of C6 necessary or useful to ensure a consistent application of the definitions and exemptions?

### 2.3. Issues for discussion
In large part, ESMA’s technical advice is designed to give clarity to the Level 1 text.

In order to ensure uniform application of the exemptions to physically settled energy products, would it be useful to further specify elements of the proportionate arrangements which parties must have in place before entering into such contracts? At a minimum, this would likely need to include certain elements contained in the discussion of ESMA’s technical advice: namely “The principle of proportionality should, in this case, be understood as requiring that the parties to the contract have arrangements in place which are adequate considering, for example, the size of their commercial activities or their production, storage or consumption capabilities.”.

Further elements could include the specification that proportionate arrangements should be available on a commodity-by-commodity basis (or to the very least an indicative range within which capacity fungibility is available), and that parties should have the access to physical capabilities and the necessary licenses. For instance contracts with the TSO could be a necessary condition to benefit from the exemption.

Regarding the inclusion of a quantitative specification of capacity to make or take delivery, it is likely that one single figure would not be suitable for different market participants. One could therefore consider indicative ranges of capacity measures depending on a set of parameters and which if exceeded would put the burden on the firm in question to satisfy itself of the reasons why it should nevertheless be considered for physical delivery. These parameters could include the size of market, the number of participants or turnover rates.

**Do you agree with ESMA’s technical advice? Is additional clarity needed to specify the ‘proportionate arrangements’? If so, what quantitative or qualitative specifications might need to formulated?**

3. Specifying Section C7 of Annex I

3.1. C7 Summary of ESMA’s technical advice

ESMA was invited to update the definition of C7 financial instruments by taking into consideration the introduction of the OTF venue and the removal of the clearing/margining requirement.

C7 financial instruments are defined as “Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C6 and not being for commercial purposes, which the characteristics of other derivative financial instruments”. ESMA’s mandate was to determine if any changes were required to the existing level 2 rules under MiFID I.

ESMA determined that the existing rules were largely still valid. In particular, it considered that the trading and standardisation factors were still relevant for the definition. Furthermore, it re-asserted the view that commodity spot contracts should be understood as for delivery within two trading days or the period generally accepted in the market. The advice also removes the reference to clearing in the definition, since it considered it created circularity with EMIR.
Following responses from its consultation process, ESMA decided to retain the existing definition of a contract being for commercial purposes (Art 38 of Regulation (EC) No 1287/2006 implementing MiFID I 2004/39/EC) This definition is narrowly framed and limited to the energy sector. It is defined when “it is entered into with or by an operator or administrator of an energy transmission grid, energy balancing mechanism or pipeline network and it is necessary to keep in balance the supplies and uses of energy at a given time”.

3.2. Discussion of C7

ESMA’s technical advice remains largely unchanged regarding the specification of C7 because the trading and standardisation criteria still apply. Together with the removal of the clearing criteria, the definition seems to be fit for purpose.

It is however noteworthy that ESMA chose not to extend the application of the ‘commercial purpose’ exemption to sectors other than energy, despite nothing in the C7 definition restricting the usage of this exemption to energy instruments only. In its discussion, ESMA notes that whilst it was open to extending the application of the exemption to other sectors, it did not receive specific examples of contracts which would be as narrowly framed as the energy exemption. It would remain open to additions to this exemption should specific examples be identified.

Since the level 1 text does not restrict the usage of this exemption to one particular asset class; and given the fact that wholesale energy contracts already benefit from carve-outs in the C6 definitions, the extension of the commercial purpose exemption to other sectors could be considered. In particular, it should be considered whether narrowly framed exemptions for the agricultural sector would be appropriate.

Indeed, agricultural cooperatives and farmers sell their production using a large proportion (between 10 and 50%) of forward contracts linked to settlement prices of futures/contracts trading on venue; and these contracts would become financial instruments under C7. In turn, the only activity of certain agricultural cooperatives is to buy forward from the farmers, and sell forward to industry agricultural products. As a result, they might fail the ‘ancillary activity’ test and be fully captured by MiFID requirements for investment firms. In any cases however, farmers and agricultural players will have to comply with reporting obligations.

Level 1 does not provide exemptions for such forward contracts, unless they are entered into for commercial purposes. There is therefore a legitimate question as to whether certain contracts entered into for commercial purposes by the Agricultural sector should be considered financial instruments or not.

3.3. Issues for discussion

Should consideration be given to specifying further categories of contracts which are for commercial purposes? These contracts would need to be clearly defined in order to avoid regulatory loopholes and sectoral carve-outs. Further work would need to be undertaken to frame the type of contracts which can benefit from the commercial purpose exemption.

Do you agree with ESMA’s technical advice on specifying C7?
Are there other contracts that should be specified as being for commercial purposes? If so which ones?

4. Are there any other issues you would like to raise in relation to this section of ESMA advice?
1. Introduction

The treatment of FX spot and FX forwards under MiFID 1 was discussed extensively in 2014 when the Commission issued a consultation document on 10 April 2014. Given that Directive 2010/78/EU (Omnibus I) introduced a sunset clause in Article 64a MiFID I, the delegations to the Commission under MiFID I ceased to apply after 1 December 2012; and it was not possible to address the consistent definition of FX by way of a MiFID 1 implementing measure.

Under the implementing measures for MiFID 2 (Directive 2014/65/EU) there is the possibility to bring legal certainty on what an FX contract is. This non-paper therefore uses the outcome of the work previously conducted in order to the discussion on solutions to the treatment of FX.

Financial instruments are defined in Section C4 of Annex I of the Directive on markets in financial instruments (MiFID 2) and include derivatives related to currencies (FX). However while Article 39(2) of Regulation (EC) No 1287/2006 (MiFID L2) provides a specification of what constitutes a spot contract for the purposes of commodities, none is provided for a spot FX contract. It emerged during ESMA task force discussions related to EMIR implementation, that there were wide differences in national implementation of MiFID in respect of FX forwards and spots. Responses to the 2014 consultation suggest that classifying an FX contract would mainly have an impact through in two areas:-

A. Regulation on OTC derivatives, central counterparties and trade repositories (EMIR):

(1) Mandatory reporting of FX transactions into trade repositories would be required;

(2) FX contracts may be taken into account for the calculation of the clearing threshold;
(3) A **clearing obligation** and **bilateral risk mitigation techniques** for non-centrally cleared FX transactions *may* be required under level 2 measures.

**B. Directive on markets in financial instruments (MIFID II):** Classification of an FX contract as a financial instrument may therefore bring an entity within the authorisation requirement and subject them and this activity to other obligations such as the **investor protection** and algorithmic trading regimes.

2. **Definition of FX Spot or FX Forwards**

The level 2 measures could clarify what a spot FX contract is and therefore what is excluded from MIFID II, as per the approach used to define commodity spot contracts.

3. **Settlement Cut Off Period and Qualifications**

Concerning the settlement cut-off period that delineates spots, responses to the consultation suggested that a settlement period of 2 days would reflect what immediate delivery for a spot contract means in practice but that "qualifications" may be necessary to cover special cases where 2-day settlement is not possible but the contract should nonetheless be considered a spot. Days would be defined in terms of business, trading or banking days to adjust for holidays on both sides of the currency pair.

4. **Qualification I – Standard market practice/delivery period**

For major currency pairs (the most common ones), T+2 (or less) may be the appropriate cut off period for a spot, but for other currency pairs, longer settlement periods would likely be required and thus the “standard delivery period” should be allowed for the rest, for example:

- T+2 settlement period to define FX spot contracts for European and other major currency pairs (Euro, UK Sterling, Croatian kuna, Bulgarian lev, Czech koruna, Danish krone, Hungarian forint, Polish zloty and Romanian leu (EU Member States currencies), US dollar, Japanese yen, Australian dollar, Swiss franc, Canadian dollar, Hong Kong dollar, New Zealand dollar, Singapore dollar, Norwegian krone and Mexican peso (BIS most traded currencies)).

- "standard delivery period" for all other currency pairs to define a FX spot contract.

5. **Qualification II – Security Conversion Transactions**

FX contracts may be used for the purchase of foreign securities whose settlement cycle is longer than T+2 and, as a result, this collateral FX payment contract has to settle longer than T+2. Classifying such contracts as derivatives could be detrimental to international capital flows, in particular the investment funds industry, many of whose mandates do no permit dealing in derivatives. Therefore FX contracts for such “Security Conversion Transactions” should be considered spots. Where contracts for the exchange of currencies are used for the
sale of a transferable security, to use the accepted market settlement period of that transferable security to define a FX spot contract, subject to a cap of for example, 5 days, might avoid the creation of loopholes..

6. Qualification III – Payment purposes

Concerning FX contracts for non-investment, commercial or payment purposes, given the fact that MiFID is intended to cover financial instruments but not payment instruments, international payments for trade and exports should not be unduly burdened, therefore a FX contract that is used as a means of payment to facilitate payment for goods and services could also be considered as an FX spot contract.
Commission services non-paper 4/2/2015

MIFID II – main issues in relation to the preparation of Commission delegated Acts

Microstructural issues

Definitions of “algorithmic trading” and “high frequency algorithmic trading technique”

Disclaimer: The information contained in this document has been prepared by the services of DG FISMA and is intended only for discussion purposes at the EGESC meeting. It does not purport to represent or prejudge the Commission's final position. The Commission intends to conduct this exercise taking into consideration the need to achieve the objectives of encouraging growth, maintaining effective investor protection and promoting financial stability. An impact assessment will accompany the relevant delegated acts, being mindful of the cumulative effect and the need to avoid unintended consequences. We would therefore welcome suggestions to this end.

1. Introduction

Any person that applies a high frequency algorithmic trading technique (HFT) is required to be authorised as an investment firm and is subject to enhanced organisational requirements (Articles 2(1)(d)(iii) and 17(2) MiFID II). It was considered necessary to further clarify this definition in a delegated act to ensure the uniform application of the authorisation and organisational requirements. ESMA has therefore provided its technical advice on the matter.

Article 4(1)(40) of MiFID II defines high frequency algorithmic trading technique as “an algorithmic trading technique characterised by: (a) infrastructure intended to minimise network and other types of latencies, including at least one of the following facilities for algorithmic order entry: co-location, proximity hosting or high-speed direct electronic access; (b) system-determination of order initiation, generation, routing or execution without human intervention for individual trades or orders; and (c) high message intraday rates which constitute orders, quotes or cancellations”.

Recital 61 states that high frequency trading (HFT) is a specific subset of algorithmic trading.¹ Recital 63 further explains that it is desirable to ensure that all high frequency algorithmic trading firms be authorised to ensure they are subject to organisational requirements under the Directive and are properly supervised.

Therefore, any further specification of the definition of “high frequency algorithmic trading technique” should be sufficiently broad to ensure that all genuine high frequency (HF) traders will be caught and dynamic enough to cope with market and technological developments.

¹ Article 4(1)(39) of MiFID II, ESMA also provided technical advice on some aspects of the definition "algorithmic trading” which will not be discussed further as there appears to be broad consensus on this aspect.
In its technical advice ESMA has analysed the third limb of the test (the high intraday messaging rate)\(^2\) but was unable to reach a conclusion on the appropriate way forward. ESMA instead has advised the European Commission to follow one of the three options described below as proxies for the identification of “high message intra-day rates”:

1. **Absolute threshold per instrument**: a participant/member would be deemed to have a “high message intraday rate” when the average number of messages sent per trading day to any single liquid instrument traded on a venue is above 2 messages per second.

2. **Absolute threshold per trading venue and per instrument**: a participant/member submitting on average at least 4 messages per second with respect to all instruments across a venue or 2 messages per second traded with respect to any single instrument traded on a venue would be deemed to have a “high message intraday rate”.

3. **Relative threshold**: a member or participant in a trading venue would be deemed to have a “high message intraday rate” where the median daily lifetime of its modified or cancelled orders falls under a threshold below the median daily lifetime of all the modified or cancelled orders submitted to a given trading venue. If the Commission decides to follow this approach, ESMA recommends setting that threshold between the 40th and the 20th percentiles of the daily lifetime of modified or cancelled orders from all members or participants on a trading venue.

In its technical advice, ESMA also made some additional recommendations that will be discussed later below.

### 2. Evaluation of advantages/disadvantages of the options

In its technical advice ESMA discusses a number of advantages and disadvantages of each option. Below is an overview which assesses the options based on the following relevant parameters: ease of administration, time proof, circumvention/gaming risk, level playing field and coverage.

#### Ease of administration

**Options 1 and 2**: Simple to assess directly at any time by individual firms since it is based on the activity of individual firms as opposed to individual firms’ activity in relation to other firms.

**Option 3**: Cannot be directly assessed by individual firms since setting thresholds requires prior periodical calculations by the trading venues thus adding a level of complexity.

#### Time proof

\(^2\) It being noted that the other two limbs of the HFT definition must set out in Article 4(1)(40) - no personal intervention and low latency - must be met.
Options 1 and 2 can become technically obsolete and may have to be revised frequently in case of increased transaction speed.

Option 3 is more 'future proof' since it does not need to be changed as a result of increased speed of transactions and is less difficult to circumvent.

**Circumvention / gaming risk**

Options 1 and 2: It would be theoretically possible to circumvent as one can trade just below the thresholds in individual instruments or across multiple instruments.

Option 3: It would be theoretically possible to extend the life time of orders (hence increasing the median to which the threshold is set) to avoid being classified as HFT.

**Level playing field**

Options 1 and 2: ESMA considers that it will lead to more activity being classified as HFT on large venues (with more liquid instruments) compared to small venues, something which on the other hand would not seem consistent with policy objective as more HFT activity can be expected in large liquid venues.

Option 3: Setting different thresholds per venue based on the life time of orders on them may lead to firms being qualified as HFT depending on the size of the trading venue, the number of liquid instrument at a venue and the speed of trading activity of other market participants (i.e. no "floor", firms on smaller less illiquid venues could be captured).

**Firm /trading coverage**

ESMA has carried out an empirical analysis to assess coverage resulting from Options 1 and 3. Method used: comparing the outcome (number of firms, percentage value of trade) of applying the thresholds on trading data with a total population of firm identified on the basis of a direct approach (i.e. identification of a population of firms on different venues which are labelled as carrying out HFT and including the trading desks of investment banks)("total population").

Option 1: Firms: 21 firms vs. a total population of 1211 firms and 13% of total trading value of total population (investment banks included).

Option 2: No assessment provided. Likely to be higher since it covers also multi-instrument strategies.

Option 3: Depending on the percentile threshold used (20th to 40th), 216 to 438 firms compared to a total population of 1211 firms and 31% to 59% of total trading value of total population (investment banks included).

**Strategy coverage**

Option 1: lesser scope than Option 2 and 3, since it covers single instrument strategy only.
Option 2: both single and multi-instrument strategies.

Option 3: both single and multi-instrument strategies.

3. Discussion points based on the above considerations

Considering its relatively narrow coverage, some might argue it is difficult to reconcile Option 1 with the objectives of MIFID II which is to ensure a broad coverage of HFT activity (cf recital 63 “it is desirable to ensure that all high frequency algorithmic trading firms be authorised to ensure they are subject to organisational requirements under the Directive and are properly supervised” (emphasis added)). Therefore, any identified advantages of this option would seem to be outweighed by the sub-optimal coverage in terms of firms, proportion of trading and type of strategies.

As regards the other Options, by adding the criterion to cover multi-instrument strategies under Option 2, it will likely provide a broader coverage than Option 1. At the same time, Option 2 provides a degree of simplicity and clarity and would appear be significantly less costly to implement and administer compared to the former. While empirical data suggest a broad scope under Option 3, the risk of circumvention may be higher under this Option than under Option 2.

Questions:

- Do you agree with the above analysis?
- Should other aspects be considered?
- What are your preferences towards options 1-3 or do you think any alternatives should be considered?

4. Additional recommendations by ESMA

Initial approach

In its technical advice ESMA also recommends that at least in a first phase (considering as such until the assessment of the report foreseen in Article 90(1)(c) of MiFID II), the identification of HFTs is focused on liquid instruments only.

In this regard, HFT typically takes place on liquid instruments so the approach would be consistent with the overall policy objective pursued. In addition, limiting the scope to liquid instruments would seem to address some of the short comings of all the options, especially regarding level playing field aspect as it would seem to eliminate or at least partly eliminate one important factor which would lead to different impact on different (large liquid vs. small illiquid) trading venues.

Question: do you agree/disagree?

Periodicity of threshold setting
In its technical advice ESMA recommends that the calculations are made:

a. For the absolute approach, on a rolling basis by the trading venue considering the preceding 12-months; or,

b. For the relative approach, on an annual basis by the trading venues at the same time as the annual transparency calculations.

**Question:** do you agree/disagree?

**Proprietary vs. all trading in scope**

For the identification of high frequency trading, ESMA is of the view that only proprietary order flow should be considered. This is not a defined term under L1 but what is envisaged appears to be trading on own account as defined in Article 4.1(6) MiFID (i.e. not executing orders on behalf of clients per Article 4.1(5) MiFID).

Whether a trade is proprietary or not goes beyond the specific issue of intra-day messaging as it is matter of more broadly clarifying what is the scope of HFT compared to algorithmic trading. In this regard recital 61 lends support to this approach by providing that "[h]igh frequency algorithmic trading is typically done by the traders using their own capital to trade and rather than being a strategy in itself is usually the use of sophisticated technology to implement more traditional trading strategies such as market making or arbitrage."

ESMA also suggests in its technical advice that if an investment firm is classified as HFT, the firm may challenge this classification if they believe this is a direct result of their non-proprietary messaging flow and proposes a process for this challenge. In this regard, setting out in the definition a process to challenge certain parameters would go beyond the legal mandate to provide clarifications on a definition. It suffices to clarify in the definition what is the scope of the HFT provision (the process of challenging would have to be dealt with by each NCA and ESMA might consider guidelines if necessary going forward).

**Question:** Do you agree/disagree with the above suggestion on scope?

**HFT and algorithmic market makers**

In its technical advice ESMA recommends including in calculations firms pursuing market making strategies, as described by Article 17(4) of MiFID II, and therefore should be considered in the calculations.

In this regard, this is consistent with the reasoning above as regards own account trading (again see recital 61).

**Question:** do you agree/disagree?
MIFID II – main issues in relation to the preparation of Commission delegated Acts

The legitimacy of inducements to be paid to/by a third person

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1. Introduction

MiFID II rules have strengthened the requirements for third party payments and benefits (the so-called inducements). To this end, and in line with recital 74, Article 24(7)(b) and 24(8) of MiFID II state that when an investment firm provides investment advice on an independent basis or portfolio management, it shall not accept and retain fees, commissions or any monetary or non-monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of the service to clients. Minor non-monetary benefits that are capable of enhancing the quality of service provided to a client and are of a scale and nature such that they could not be judged to impair compliance with the investment firm’s duty to act in the best interest of the client should be clearly disclosed and are excluded from this provision.

In all other cases (than those mentioned under Art 24(7) and 24(8)), MiFID II subjects the reception and payment of inducements to strict requirements: the inducement, clearly disclosed to the client, is a) designed to enhance the quality of the relevant service to the client, and b) does not impair compliance with the investment firm’s duty to act honestly, fairly and professionally in accordance with the best interest of its clients (Article 24(9) of MiFID II).

Several provisions empower the Commission to develop delegated acts to specify further some of these requirements. ESMA has provided technical advice specifying the requirement for firms providing investment advice on an independent basis and portfolio management not to accept inducements, with the exception of minor non-monetary benefits, as well as the conditions under which inducements are not deemed to meet the quality enhancement requirement. Also, the ESMA technical advice contains some related disclosure and organisational requirements.

2. Investment research

MiFID II (Articles 24(7) and 24(8)) provides for a general prohibition for investment firms providing portfolio management and investment advice on an independent basis to accept and
retain any monetary or non-monetary benefits paid or provided by any third party in relation to the provision of the service to clients (inducements). The only exception to this prohibition concerns minor non-monetary benefits that are capable of enhancing the quality of service provided to a client and are of a scale and nature that they could not be judged to impair compliance with the investment firm’s duty to act in the best interest of the client and which should be clearly disclosed to clients.

A. ESMA’s technical advice

ESMA noted that based on a common market practice, research is often received by portfolio managers from brokers with whom the portfolio manager executes orders on behalf of its clients. While execution and the provision of research are two distinct services, a common pricing and delivery strategy is to bundle them into a single service paid through dealing commissions (charged to clients). ESMA noted that research provided by brokers to portfolio managers may unduly influence the behaviour of the recipient and affect compliance with portfolio managers’ obligations to act in the best interest of their clients when selecting and using the services of the brokers to whom orders on behalf of clients are directed. ESMA had referred to portfolio managers’ practices to agree higher execution rates to allow them to also obtain higher value research from a broker (i.e. the additional services from the broker are explicitly cross subsidised by the transaction charges taken from the portfolio manager’s client’s funds). A firm may also be influenced to direct order flow or ‘churn’ client portfolios to gain access to more valuable research services for ‘free’.

Furthermore, notwithstanding the criticism, many respondents recognised that the reception of research by portfolio managers from a broker may raise concerns of compliance with the overarching requirements to ensure fair treatment of clients.

ESMA also pointed out that the conditions under which certain market arrangements are currently operated often do not entirely address the conflicts of interests at stake and still enable amounts charged for research by the investment firm to be determined by the volume of transactions of the investment firm with the executing broker. Also, such arrangements do not guarantee a fair allocation of research costs to the client’s portfolio.

ESMA explains that it has therefore formulated additional requirements which are aimed at further limiting conflicts of interest and make clear that there should be no payment for third party research linked to the payments made for execution of orders. According to ESMA, the proposed approach will also create more transparency over spending on research to improve outcomes for consumers as well as ensure transparency with respect to both execution of orders and research services.

Based on the results of its consultation, ESMA's technical advice puts forward a solution aiming to identify the conditions under which research could not qualify as an inducement in accordance with Article 24 (7)(b) and (8) and could therefore be allowed beyond the limits imposed by MiFID II for minor non-monetary benefits.

Following the ESMA’s technical advice, the provision of investment research should not be regarded as an inducement if it is received in return for:

i. direct payments by the investment firm out of its own resources (which they may choose to reflect in an increase to the firm’s portfolio management or advice fees), or

ii. payments from a separate research payment account controlled by the investment firm and funded by a specific research charge to the client.

The ESMA's technical advice sets a number of other detailed requirements on the governance of the research payment account: (a) the firm must set a research budget not linked to
transactions; (b) it agrees the research charge with the client (and may only increase it with the client’s written agreement); (c) it has in place a number of governance arrangements to ensure quality of research and accountability to clients; (d) ex-ante and ex-post disclosures to clients. Additional requirements for firms offering execution of orders and research services to price and supply these services separately are also suggested.

B. Issues for discussion

Do you agree that the ESMA’s technical advice strikes the right balance between stakeholders’ and regulatory concerns?

In particular, do you agree that the ESMA’s technical advice (by breaking the link between research and execution) sufficiently addresses the inefficiencies identified in relation to current practices and arrangements and will act as a behavioural incentive on portfolio managers to obtain value for their clients in research spending? Do you agree that the ESMA’s technical advice will lead to transparent pricing of research which in turn could have a number of beneficial effects, including:

• Matching supply and demand in the research market.
• Allowing for efficient allocation of resources.
• More competition in the research market?

Do you agree that the ESMA’s technical advice reduces the principal-agent problems, by empowering clients, informed about the cost of research, to hold investment managers accountable for research purchased? Also, there would be no more incentives to churn a client portfolio to access research since research and execution payments will be separated. Furthermore, compliance with best execution requirements would also be facilitated (the execution rate will only cover the transaction costs and would not subsidise other services or products).

Do you agree that With respect to the implementation of the requirement for firms to agree with each client the research charge, do you agree that further clarification should be provided and alternative workable solutions to the one suggested by ESMA could be further assessed? While preserving the principle that clients are effectively made aware of the research charge (and its subsequent increases), do you agree with the idea of refining the ESMA’s technical advice to, allow firms to standardise the process across portfolios with common strategies?¹

3. Quality enhancement

While investment firms providing independent advice and portfolio management are prevented from accepting and retaining inducements, in other cases MiFID II (Article 24(9))

¹ The charge could be a % of assets under management (AuM) (e.g. x basis points, although an approximate cash-figure could also be provided). There may however be cases where a large single client (e.g. a large pension fund) might warrant a bespoke budget and charge level, or if mandates are particularly specialised (e.g. mandate with very specific ethical or environment sustainability objectives). Some standardisation of charges and policy of how costs will be allocated between clients could form part of a basic written policy by firms (avoiding concerns that some clients might be able to reject charges but still benefit from same research received and paid for by other clients on a commonly managed group of portfolios). The “agreement” could be obtained at the point of first agreement with clients in same way as annual management charge (AMC). Essentially, how a firm agrees for instance their management fees with clients should be comparable to how a new research charge is confirmed.
allows investment firms to receive an inducement provided that it is disclosed to the client and that a) it is designed to enhance the quality of the relevant service to the client, and b) it does not impair compliance with the investment firm’s duty to act honestly, fairly and professionally in accordance with the best interest of its clients.

A. ESMA’s technical advice

The ESMA’s technical advice sets out a non-exhaustive list of circumstances and situations to be considered when determining whether the quality enhancement test is met or not.

An inducement is generally regarded as not designed to enhance the quality of the relevant service to the client in any of the following situations:

“i. it is not justified by the provision of an additional or higher level service to the relevant client, proportional to the level of inducements received, such as:

a) the provision of non-independent advice on and access to a wide range of suitable financial instruments including an appropriate number of instruments from third party product providers having no close links with the investment firm; or

b) the provision of non-independent advice combined with either: an offer to the client, at least on an annual basis, to assess the continuing suitability of the financial instruments in which the client has invested; or with another ongoing service that is likely to be of value to the client such as advice about the suggested optimal asset allocation of the client; or

c) the provision of access, at a competitive price, to a wide range of financial instruments that are likely to meet the needs of the target market, including an appropriate number of instruments from third party product providers having no close links with the investment firm, together with either the provision of added-value tools, such as objective online information tools helping the relevant client to take investment decisions or enabling the relevant client to monitor, model and adjust the range of financial instruments in which they have invested, or providing periodic reports of the performance and costs and charges associated with the financial instruments;

ii. it directly benefits the recipient firm, its shareholders or employees without tangible benefit to the relevant client; or

iii. in relation to an on-going inducement, it is not justified by the provision of an on-going benefit to the relevant client.

In assessing whether or not the enhancement test can be met in accordance with these conditions, a fee, commission or non-monetary benefit may be considered acceptable only if all relevant services are provided to the clients without bias or distortion as a result of the fee, commission or non-monetary benefit being received.”

Some record-keeping requirements are also introduced.

B. Issues for discussion

Taking into account comments from market participants and in particular about possible unintended effects of reducing clients’ access to investment advice or discouraging so-called “open architecture” models or not taking into account the non-advisory area of services, ESMA identified a broader list of situations in which the benefit for the client is more direct and tangible (inducements would be allowed where high-quality advice is provided or where access, at a competitive price, to a wide range of financial instruments together with either the
provision of added-value tools or periodic reports of the performance and costs and charges associated with the financial instruments is provided).

Do you agree with the ESMA’s technical advice?

4. Level playing field concerns
The Commission services take note of several EGESC members’ comments with respect to the need to ensure a level playing field across different legislations, in particular with respect to the UCITS and AIFM directives (in order to ensure a level playing field between categories of asset managers) or the inducements rules applicable to insurance-based investment products.

Views are welcome on the best way to deal with these concerns and in particular on ESMA’s advice to the Commission to consider the possibility of aligning the relevant provisions that fall under UCITS and AIFMD with the MiFID II implementing provisions on inducements, bearing in mind that current UCITS and AIFMD provisions on inducements are aligned with the MiFID I implementing measures on inducements?
I. Introduction

Articles 64(1) and 65(1) of MiFID II and Articles 13(1), 15(1) and 18(8) of MiFIR foresee that the Commission "shall adopt delegated Acts […] clarifying what constitutes a reasonable commercial basis" to provide data covered by the MiFID transparency requirement (the "mandates"). The purpose of this set of rules is to ensure that market participants have access to data necessary for their trading activities at reasonable costs and other commercial terms. This requirement is an essential aspect of ensuring an effective transparency regime and to overcome market dispersion.

In addition to the mandates Article 12(1) sets out a mandate on the compulsory level of disaggregation of trading data which is specified in regulatory technical standards (see ESMA consultation paper p. 448).

Trading data

Market participants can choose between different types of trade data, and whether they purchase direct from the trading venues (usually reducing latency), or indirectly through a broker or vendor (which may provide analysis services but additional latency). Data provided can either be real-time (or within seconds) or historic (usually after 15 minutes). Real time data are used actively in day-to-day trading, whereas historic data are more for analytical purposes (e.g. constructing trading benchmarks or evaluating trading strategies). Data includes information on the best bid and offer prices for each security as well as all executed trades and may further include market depth data to various degrees.

Data is also differentiated by the type of trading it refers to. Pre-trade data provides information on the amount of bids and offers for a particular security at a specific point in time. These data are also known as order book data, as they convey information about the supply and demand at a given point in time. Pre-trade data are used inter alia to assess the market impact a given transaction would have. This type of data is usually sold in differentiated product types depending on the depth of the order book included. Post-trade data is information about the price and size of a given
financial transaction. Typically they are used to assess the contemporaneous market price of a specific security.

Trading data supply chain

The empowerments for delegated acts under MiFID II relate to the contributors to the trading data supply chain which are within the scope of MiFID II, i.e. trading venues, systematic internalisers, approved publication arrangements and consolidated tape providers (see below graph of the supply chain of trading data from trading venues to end consumers) ("data providers").

Among these categories, the most important category for the present purpose is that of trading venues as they are today the main primary source of trading data and thus constitute the first step of the supply chain. It is estimated that there are at least 230 primary sources of trading data in the EU.\(^1\) The empowerments for delegated acts do not regulate the downstream distribution of trading data by data vendors/aggregators since such activity is outside the scope of MiFID (see below discussion as to the relevance of this issue for the analysis). A graphic schematic representation of the trading data supply chain in the EU is provided below.

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\(^1\) According to PWC there were 238 sources of data in the EU: 89 Regulated markets, 137 MTFs and 12 Systematic internalisers. PwC (2010) ‘Data gathering and analysis in the context of the MiFID review: Prepared for Directorate General Internal Market and Services, European Commission.
Economic framework for the analysis

According to existing data, the comparatively high prices for trading data in the EU in comparison to the US, create barriers to the provision and usage of market data, impair information flow and the price discovery process; hence the need to ensure that trading data are provided on a reasonable commercial basis as acknowledge by the European Parliament and the Council in MiFID II/ MiFIR. There are diverging views on the causes of higher prices in the EU.

In economic theory terms, the main opposing views are, on the one hand typically from the trading venues' perspective, that US markets due to their size deliver economies of scale for the provision of data compared to the fragmented and more complex structures of EU markets as well as a different regulatory framework (centralised system with data purchase obligation for consumers together with a revenue share arrangement for producers). They argue that the pricing of (i.e. recovery of cost of producing) trading data should not be analysed separately from execution services since they are joint products (i.e. jointly produced), i.e. competition takes place on a venue level for both trade execution and trading data together. Therefore intervening to decrease the price of one will likely only have distribution effects (increasing the price of the other) (Oxera Pricing of market data services; February 2014).

Against this opinion is the view typically expressed that higher prices are the outcome of insufficient competitive forces in relation to trading data. Unlike the provision of trade execution, there is no or limited substitutability between the trading data offering of different trading venues. Even if trading data are jointly produced products they are separately consumed products, i.e. trading data from venue A is not substitutable for trading data at venue B for a participant wishing to trade on venue B and a market participant wishing to assess best execution for instruments traded on more than one venue must obtain data from all relevant primary sources). Therefore, pricing of trading data should be analysed separately from that of trade execution (where there is generally effective competition) (Copenhagen Economics: Regulating access to and pricing of equity market data; 12 September 2013).

II. Options

A. Options discarded by ESMA: revenue cap and LRIC+

In its technical advice, ESMA examined three main options. On the option of limiting data charges by imposing a limit on the share that data revenues can have of total venue revenues (Option B in the consultation), ESMA does not recommend this option considering it neither practical nor likely to be effective. Neither does ESMA recommend the option of limiting data charges by reference to costs, defined as Long-Run Incremental Costs plus (Option C). ESMA advises that this option contains interesting ideas but is not a workable solution as it would impose too burdensome a cost on venues and others, including their supervisors, and would present significant challenges to implement.
ESMA in its technical advice have set out detailed advantages and disadvantages of these options. In essence they can be summarised as follows.

As regards Option B, the revenue cap, the benefit of this mechanism would be, if successful, that it would constrain the overall pricing of trading venues. That is, to respect the rule that data sales cannot exceed X% of total revenues, there would be a need to constrain pricing of data taking into account the pricing of trade execution, where there is no dispute that there is generally speaking competitive conditions in the market. However, the draw-back is that the interference with trading venues differing business models in terms of revenues generation would be arbitrary unless the threshold for a cap takes into account such differences (i.e. setting a threshold for each venue or category of venues). At the same time, elaborating such varying thresholds would be overly complex, difficult to adapt over time and hence costly.

As regards Option C, the long run incremental cost (LRIC) rule, would if successful provide a tool to set trading data fees at a level which would have prevailed where a supplier is subject to a normal degree of competition. However, drawbacks identified are essentially the costs of constructing a model, including defining what is a reasonable increment, the definition of common costs, finding parameters to define what data should be used and what assumptions on which to build the model can be generally accepted e.g. value of future investments, cost of capital, rate of depreciation amortisation etc.)

For both models, there is also the consideration of cost for the industry and the enforcement costs for national competent authorities (NCAs).

B. Option: A + cost based provision of data, additional requirements and transparency

On the option of a principles and transparency based approach ("Option A"), ESMA recommends that the European Commission should introduce it, enhanced as Option A+, so as to make it more effective than the model consulted on, including criteria to enable venues, customers and competent authorities to assess whether data sales are on a reasonable commercial basis and transparency requirements to be made public.

Question: considering the identified drawbacks, views are welcome on which option best achieves the objectives set out.

1. Cost based provision of data

It is essential in order to fulfil the L1 mandate that there is a "substantial test", i.e. criteria which clarify what reasonable commercial basis is. Merely imposing a transparency obligation on data generators would stop short of fulfilling the mandate as this is a procedural obligation rather than a rule which clarifies what reasonable commercial basis means.

For this purpose, ESMA proposes a set of criteria to indicate whether data have been sold on a reasonable commercial basis:
• The level of prices charged for data should be based on the costs for producing and disseminating data, including an appropriate share of joint costs.

• Any increases in prices should reflect changes in costs attributable to data sales, including both the direct costs of data production/dissemination and changes to the appropriate share of joint costs.

• The differentials in prices charged to different categories of customers should be proportionate to the value of the data to those customers, taking into account:
  
  o the scope and scale of the data (e.g. number of instruments, volume of trading)

  o the field of use of the data (e.g. is it for the customer’s own trading, for on-selling, or for creating value added data products?)

**Question:** views are welcome on this proposal from ESMA. Are the above criteria sufficient or is there a need to further specify what constitutes "costs" of "producing and disseminating data" and "appropriate share of joint costs" and if so how?

### 2. Additional requirements to provide data on a reasonable commercial basis

ESMA in its technical advice also provide additional requirements necessary to fulfil the reasonable commercial basis requirement.

#### 2.1 Unbundling vs. disaggregation

In its technical advice, ESMA proposes that Data should be available for sale on its own, without being bundled with other services and disaggregated as foreseen in articles 12 and 13 MiFIR. In this context, it is important to distinguish two set of terms: (1) combining/disaggregating and (2) bundling/unbundling. The first pair refers to putting different types of data into packages (e.g. providing only a combination of data for a set of instruments, instead of offering data on individual instruments). This aspect is covered in regulatory technical standards under article 12 MiFIR.

The purpose of disaggregation is to ensure that data purchasers can obtain the data which suit their needs.

The purpose of the unbundling is to ensure that data is available to data purchasers which do not need trade execution or other services from the trading venue which generated the data.

**Views are welcome on the ESMA proposal,** and whether it is necessary to stipulate that to fulfil the obligation to provide trading data on a reasonable commercial basis the provision of trading data must be unbundled from that of other services and pricing of trading data must be based at least on the level of disaggregation foreseen in article 12 MiFIR as further refined in regulatory technical standards.
2.2 Non-discrimination

An important part of the reasonable commercial basis concept is to ensure that data provision is provided on a non-discriminatory basis. In this regard ESMA proposes the following:

- Providers should offer the same prices, and other terms and conditions, to all customers who are in the same position according to published, objective criteria.

- Trading venues should have scalable capacities so as to ensure that their members can always access their data feed on an equal footing as the other clients buying the same type of feed and through the same channel.

**Question:** do you agree with the above proposed criteria?

2.3 Third party suppliers

If a trading venue makes its data feed available only in such a way that customers need to use the services of a third-party supplier (e.g. an external IT provider for decryption), then it should be the responsibility of the trading venue to ensure that the overall data service is available to customers on a reasonable commercial basis, including on a non-discriminatory basis.

This provision is meant to ensure clarity that responsibility remains with the data provider also when it has outsourcing arrangements.

**Question:** do you agree with the above clarification?

2.4 Unit of account and per-user pricing

Multiple charging of the same data was a concern that was raised in the public consultation. As seen from the supply chain figure above, trading data is not always supplied directly from exchanges to end-users, but are often purchased through data vendors or independent software vendors. In most cases, end-users are charged based on the number of devices receiving data. As a consequence, an end-user receiving the data from an exchange through different channels may pay several times for the same data.

In order to address this issue, ESMA proposes that venues should offer their clients, along side their existing models, a new user-based “unit–of-count model” allowing them to net part of the market data costs from a single source across data vendors and across devices on a natural user level (‘per-user’ model), subject to certain eligibility conditions.

Responses to the consultation on this topic were basically split and polarised, depending on the size of the respondents. Big organisations were usually supportive, regardless of the type of business (broker/dealers, asset managers, exchanges, major data vendors). The largest consumers of market data, buy or sell side, deem the proposal as an effective step to reduce the costs of market data. On the other hand,
smaller or more medium sized organisations were against (mostly exchanges and asset managers), considering that costs would outweigh the benefits.

While the exchanges currently rely to a large extent on a few data vendors to bill and collect the fees of their end clients, the new model would force exchanges to establish and maintain a direct relationship with each end client willing to benefit from the model, increasing administrative costs of exchanges. Some consumers of market data also suggested that part of the extra costs incurred by exchanges might actually be supported by / passed onto all clients anyway, including those who did not want to, or cannot benefit from the ‘per-user’ model because of their size.

As a consequence, ESMA proposes that the offering of the per-user model should be required unless an exchange can demonstrate that there would be insufficient demand for such a unit-of-count. In particular, this would accommodate the situation of small exchanges, on which a one size fits all solution would impose an excessive burden.

In order to address the issue of charging several times for the same information to a single user, ESMA recommends that trading venues should offer their clients a “per-user” based model in addition to the existing model applicable to non-eligible clients. In elaborating the scope of this obligation due account should be taken with regard to the need for the benefit to outweigh the cost, taking into account the scale and the scope of the venues affected.

ESMA qualifies the scope of the obligation to provide price on a per user model based on “eligibility criteria” without specifying further what they should be. In this regard, to introduce eligibility criteria would seem to be at odds with the principle of non-discrimination and would leave open a loophole to restrict the per user pricing model only to certain categories of users.

As to the "insufficient demand" criteria, one may raise the concern that it may be insufficiently precise to clearly frame the obligation.

Questions:

- Do you agree/disagree with the above requirement?
- If you disagree, notably due to concerns identified above, what alternative criteria/thresholds could be considered to have a proportionate regime? Notably, would a venue size threshold be a way forward and on what basis should the threshold be set?

3. Transparency on fees and other conditions

There was broad support in ESMA's technical advice and from stakeholders to introduce as a necessary pre-requisite to fulfil the obligation to provide data on a reasonable commercial basis that there is transparency on pricing and other conditions. More transparency on the pricing of fees, content of data and costs of producing and disseminating data would enable supervisors, buyers and other stakeholders to effectively compare offerings, spot best practices, monitor compliance with the non-discrimination requirement and allow for better informed investment decisions, as investors may internalise the cost of accessing data.
ESMA has produced a list of items deemed necessary for this purpose:

3.1 Transparency on price, content and revenues

**Price**

i. Full transparency of current price lists, including
   a. Fees per display user
   b. Non-display fees
   c. Discount policies (volume and any other)
   d. Contractual terms and conditions
   e. Fees associated with different licence conditions
   f. Fees for pre-trade and for post-trade
   g. Fees for other subsets of information, including those required by the RTS under MiFIR Article 12(2)

ii. Advance (e.g. at least 90 days before) full disclosure of future price changes

iii. Availability of historic information on prices

**Information about content of data**

i. Number of instruments covered
   ii. Total turnover of instruments covered
   iii. Pre-trade / post-trade data ratio
   iv. Information about value added information enclosed
   v. Date of last licence fee adaption for each data product.

**Revenue information**

i. Revenue for data sales as a percentage of total venue revenue

**Questions:**

- Do you agree with the above list?
- Setting aside the question on transparency on costs (see below) do you consider necessary to be transparent on other conditions? Notably, point 16 of ESMA's technical advice give account of other items raised by some stakeholders:
  - unit of account policy
  - fixed access fees
  - fixed non display fees
  - netting policy for multiple products (top of market netted against depth of market)
  - standard product codes
  - entitlements codes for all major vendors
3.2 Transparency on costs

In its technical advice, ESMA provides elements for consideration on the question of whether cost of producing/disseminating data should also be subject to a transparency obligation. Under this Option the following elements are proposed.

i. Costs for collating and disseminating data
ii. Reasonable apportionment of joint costs
iii. Brief explanation of method used to calculate cost figures

ESMA also discussed whether, the information on costs should be published or provided to competent authorities only. It sets out that, on the one hand, releasing this commercially sensitive information might put the venues at a competitive disadvantage and might therefore call for requiring venues to provide cost information to their national competent authorities, rather than publishing it.

On the other hand, the option of disclosing cost information to national competent authorities only, would make it more difficult for customers to pursue their rights to obtain data on a reasonable commercial basis in court and the onus would be on competent authorities to supervise prices.

In this regard, providing information only to competent authorities cannot be categorised as a transparency obligation, it is rather a matter of a regulatory obligation to provide information for supervisory purposes, which already follows from Article 69.2 MIFID. Hence, the question is rather whether or not there should be transparency, i.e. disclosure to the public, on costs of producing trading data having regard to the advantages and disadvantages.

In this regard, as noted, for a market participant who would like to trade on and therefore purchase data from venue A, comparing the price of trading data of B would not be relevant to form a view on the reasonableness of the pricing of venue A. Therefore, even if data buyers can compare prices in between trading venues, the ability “to shop around” is limited since buyers would still have to buy the data from a particular venue if they intend to trade on that venue. In such a scenario, greater transparency of pricing of trading data would be insufficient by itself to reduce pricing of trading venues.

The advantage of making information on cost available publically is therefore to enable customers to challenge more effectively the pricing of trading data (complaint to the NCAs and/or ultimate Court action/litigation). Another advantage is that the onus of effective enforcement of this rule would not be solely on national competent authorities. Making NCAs the main responsible for intervention on the pricing policy of trading venues would indeed mean that significant resources would have to be allocated to such kind of supervision.

As to the disadvantages, if pursued, the transparency on cost obligation would be imposed on all trading venues. The data publication would be limited strictly to the provision of trading data within the scope of Article 13 MIFIR and not costs of other services or overall. Against this background, it would seem difficult to consider that any particular trading venue would be at a competitive disadvantage compared to
other trading venues since the rule would simply mean higher degree of transparency for all market players.

One concern that has been raised is that data vendors, due to the high concentration in this level of the supply chain, exercise market power and that they will be able to take advantage of increased transparency on costs and increase further their bargaining power vis-à-vis trading venues.

In this regard, the mandate provided by L1 is to achieve data provision on a reasonable commercial basis to all market participants that is effective and transparency on cost could be effective in providing users with a tool for comparability between costs and fees to challenge pricing.

If it is the case that data vendors today have strong (or excessive) bargaining power as has been suggested, this would only suggest rather that they and not other categories of direct data purchasers can obtain trading data particularly beneficial terms.

Furthermore, also for end-users which buy data from data vendors, increased transparency on costs of the “raw” trading data would appear to be a beneficial also at this level of the market since the customers of data vendors in turn can obtain more transparency on their mark-up.

In addition, more transparency on the cost of trading data could facilitate entry by new categories of data vendors and therefore contribute to decrease barriers and potentially enhance competition in the downstream data vendor/aggregators markets. This aspect is particularly relevant for the establishment of a consolidated tape provider (CTP) as foreseen in article 65 MIFID, since the success of an effective CTP is to a large extent dependent on obtaining data from the various primary sources on a reasonable commercial basis.

Finally, increased transparency on costs should also facilitate competition enforcement at all levels of the supply chain by providing competition enforcers (the Commission under EU competition rules and national authorities under national competition law) with more information about data cost and pricing directly (or on the basis of complaints from customers).

Question: Do you agree / disagree with the analysis of benefits / disadvantages and the conclusion set out above? If you agree with the need for transparency on cost, what elements should be made transparent?

3.3 Publication of information

ESMA proposes that there should be easy access to information for the public as well as regulators through publication on a central web-site as a single point of reference for any market data user.

Given that the idea of a central webpage appears to go beyond the legal mandate, alternative options to achieve the objectives may need to be considered, for example requiring data providers to provide the information on their webpage.
**Question:** could you identify other publication arrangements which fulfil the objectives of achieving transparency?
I. Introduction

The purpose of the SI regime is, firstly, to ensure that firms which deal on own account of a large magnitude by executing client orders are also subject to trade transparency requirements on a level playing field with trading venues (while at the same time taking into account the different market participants’ characteristics).

This is because such trade execution has a material impact on price formation. SIs are not allowed to bring together third party buying and selling interests in functionally the same way as trading venues (just as trading venues operators are not, with a few exceptions in Organised Trading Facilities, allowed to engage in own account trading with their clients).

The definition of what is dealing on an organised, frequent, systematic and substantial basis will therefore have a direct impact on the level of transparency for own account trading in line with article 4(1)(20) of MiFID II.

II. Options

1. Further specifying the definition of systematic internaliser (article 4(1)(20) MiFID II

According to article 4(1)(20) of MiFID II “‘Systematic internaliser’ means an investment firm, which, on an organised, frequent systematic and substantial basis deals on own account when executing client orders outside a regulated market, an MTF or an OTF without operating a multilateral system.

The frequent and systematic basis shall be measured by the number of OTC trades in the financial instrument carried out by the investment firm on own account when executing client orders. The substantial basis shall be measured either by the size of the OTC trading carried out by the investment firm in relation to the total trading of the investment firm in a specific financial instrument or by the size of the OTC trading carried out by the investment firm in relation to the total trading in the Union in a specific financial instrument. The definition of a systematic internaliser shall apply only where the pre-set limits for a frequent and systematic
basis and for a substantial basis are both crossed or where an investment firm chooses to opt-in under the systematic internaliser regime.”

ESMA was requested to provide technical advice to the Commission on how to further specify the quantitative elements of the definition of systematic internaliser (which are new compared to MiFID I) by providing advice on the numeral thresholds to be used to assess the frequent, systematic and substantial basis.

Under the scope of MiFID I, around a dozen systematic internalisers were captured. However, it can be expected that the number of firms captured under MiFID II will substantially increase. This is because the definition under MiFID II has been extended with quantitative criteria and because the number of instruments within the scope has increased (not only shares but also other equity and non-equity instruments).

The thresholds to be set in the delegated act therefore also have to account for different types of instruments now under the scope of MiFID II.

**ESMA’s technical advice:**

ESMA has taken liquid instruments into greater consideration since national competent authorities (NCAs) have the ability to waive pre-trade transparency obligations for illiquid instruments (articles 4(1) and 9(1) MiFIR), since the obligation for SIs to make public firm quotes (articles 14(1) and 18(1)) only apply when there is a liquid market and taking into account recital 18 of MiFIR, which states that appropriate pre-trade transparency requirements should apply to SIs for liquid instruments.

**A. ESMA’s technical advice for Equities (shares, depositary receipts, ETFs, certificates and other similar financial instruments)**

ESMA recommends that an investment firm internalises on a frequent and systematic basis if the number of OTC transactions executed by the investment firm on own account when executing client orders in liquid instruments is, during the last six months, equal or larger than 0.4% of the total number of transactions in the relevant financial instrument in the Union executed on any trading venue or OTC during the same period.

At a minimum the investment firm shall deal on own account in such an instrument on average on a daily basis to be considered as meeting the frequent and systematic basis criteria (‘De minimis’ threshold).

For equity instruments for which there is not a liquid market in accordance with article 2(1)(17)(b) of MiFIR, the condition is deemed to be met when the investment firm deals on own account OTC in the same financial instrument on average on a daily basis during the last six months.

As for the substantial basis criterion:

The investment firm internalises on a substantial basis if the size of OTC trading carried out by the investment firm on own account when executing client orders is, during the last six months, equal or larger than either:
a. 15% of the total turnover in that financial instrument executed by the investment firm on own account or on behalf of clients and carried out on any trading venue or OTC; or

b. 0.4% of the total turnover in that financial instrument executed in the European Union and carried out on any EU trading venue or OTC.

Investment firms shall assess whether they meet these conditions on a quarterly basis (on the first working day of the months of January, April, July and October based on the data from the previous six months).

ESMA has set the thresholds for internalising on a frequent and systematic and substantial basis taking into account feedback to its consultation paper.

In particular for smaller firms the de minimis threshold may be a useful additional reference to determine whether they fall within the scope of the SI regime. It may also be proportionate for these smaller firms to use this reference point instead of carrying out the more complicated calculations referring to total turnover.

For equity instruments for which there is not a liquid market, the threshold of trading on average on a daily basis may also be appropriate, in particular as in those markets data to calculate the total turnover in a financial instrument in the EU may be more difficult to obtain.

This threshold could also serve as a condition for the trading obligation in shares under article 23(1)(a) of MiFIR stating that investment firms shall ensure that trades it undertakes in shares admitted to trading on a regulated market or traded on a trading venue shall take place on a regulated market, MTF or systematic internaliser or on an equivalent third country venue unless they are non-systematic, ad-hoc, irregular and infrequent.

[Adopt ESMA's proposal] OR [Adopt ESMA's proposal without the de minimis threshold that an investment firm fulfils the frequent and systematic criterion for qualifying as an SI by trading at least on a daily basis in a liquid equity instrument].

**Question:** Should the 'de minimis' threshold be kept for proportionality reasons?

How could the ‘de minimis’ threshold be linked to the trading obligation for shares under article 23(1)(a)?

**B. ESMA's technical advice for Non-Equity Instruments (bonds, structures finance products, derivatives, emission allowances).**

As regards non-equity instruments, ESMA has recommended ranges for the quantitative thresholds within which to set the final thresholds. The main challenges to further specify the appropriate thresholds are that unlike in the equity sphere there is currently no consolidated data available on the overall size of markets and there are no existing SIs (in a regulatory sense) which could be used as a benchmark. Possible concentration levels in markets are also uncertain since it is not at this stage clear what choices existing or new trading platforms will
make in transforming themselves to comply with the new regulatory framework which will clearly separate multilateral and bilateral trading.

Please find below the thresholds and ranges that ESMA has provide in its final technical advice with regard to liquid non-equity instruments.

For illiquid non-equity instruments the frequent and systematic basis test shall be deemed to be met when the investment firm dealt on own account OTC in the same financial instrument, type of emission allowance or in the same class of derivatives on average once a week during the last six months.

Table 1: Thresholds for non-equity financial instruments

<table>
<thead>
<tr>
<th></th>
<th>Frequent and systematic basis threshold (liquid instruments)</th>
<th>Frequent and systematic basis threshold (illiquid instruments)</th>
<th>Substantial basis threshold Criteria 1</th>
<th>Substantial basis threshold Criteria 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of transactions executed by the investment firm on own account OTC / total number of transaction in the same financial instrument in the EU</td>
<td>Minimum trading frequency</td>
<td>Size of OTC trading by investment firm in a financial instrument on own account / total volume in the same financial instrument executed by the investment firm</td>
<td>Size of OTC trading by investment firm in a financial instrument on own account / total volume in the same financial instrument in the European Union</td>
</tr>
<tr>
<td>Bids</td>
<td>2 to 3% and at least once a week</td>
<td>3 to 5% and at least once a week</td>
<td>25%</td>
<td>0.5 to 1.5%</td>
</tr>
<tr>
<td>SFP</td>
<td>3 to 5% and at least once a week</td>
<td>3 to 5% and at least once a week</td>
<td>30%</td>
<td>1.5 to 3%</td>
</tr>
<tr>
<td>Derivatives</td>
<td>2 to 3% and at least once a week</td>
<td>3 to 5% and at least once a week</td>
<td>25%</td>
<td>0.5 to 1.5%</td>
</tr>
<tr>
<td>Emission allowances</td>
<td>3 to 5% and at least once a week</td>
<td>3 to 5% and at least once a week</td>
<td>30%</td>
<td>1.5 to 3%</td>
</tr>
</tbody>
</table>

Although the number of potential SIs will likely increase substantially from MiFID I to MiFID II, the exact population is as of yet unknown. In part due to the enlargement of the scope, in part due to the fact that firms still have to determine whether to operate on a purely bilateral (as an SI) or on a multilateral basis (MTF or, for non-equity instruments, OTF) as a result of the more strict structural separation of bilateral and multilateral trade execution provided for by MiFID II and since they will do so based on the delegated acts.

The scarcity of data on activities that in part were not under the scope of MiFID I, as well as the uncertainty with regard to the population of SIs now covered under MiFID II are some of the main challenges in setting appropriate thresholds, while failing to set clear quantitative thresholds would mean regulatory uncertainty on how to apply the transparency regime under MiFID II to Systematic Internalisers.

Since ESMA only provided ranges for the frequent and systematic criterion for liquid instruments as well as for the substantial basis criterion 2 (compared to the total nominal/notional amount traded in the European Union) it may also be possible that the thresholds applied will differ from one Member State to the other, views are welcome as to whether differences are likely to be significant enough as to undermine a level playing field in the EU.

There are several possible ways forward in setting a specific threshold for the frequent and systematic threshold for liquid non-equity instruments and for the substantial basis criterion 2 within but elaborating further on ESMA’s technical advice on non-equity thresholds for SIs:
Option 1 – Specific thresholds for frequent and systematic and substantial basis using the upper bounds of the ranges suggested by ESMA.

Using the highest percentages within the ranges provided by ESMA with regard to the frequent and systematic basis threshold for liquid non-equity instruments and criterion 2 with regard to the substantial basis should result in the lowest number of entities identified as SIs amongst the options here presented.

While the exact population of SIs under MiFID II may only become clear once the delegated acts are in place, this option would entail only a minimum level of transparency taking into account ESMA’s technical advice.

Option 2 – Specific thresholds for frequent and systematic and substantial basis using the mid-point in the ranges suggested by ESMA.

This option could be a compromise between option 1 and 3 and taking into account the data scarcity on the future SI population under MiFID II.

Option 3 – Specific thresholds for frequent and systematic and substantial basis using the lower bounds of the ranges suggested by ESMA.

Using the lower bounds as suggested by ESMA would result in a higher number of entities identified as SIs compared to the previous two options and a correspondingly higher level of transparency.

What are your views on options 1-3?
Commission services non-paper (04/02/2015)

MIFID II – main issues in relation to the preparation of Commission Delegated Acts

Specifying the requirements for SME Growth Markets

Disclaimer: The information contained in this document has been prepared by the services of DG FISMA and is intended only for discussion purposes at the EGESC meeting. It does not purport to represent or prejudge the Commission's final position. The Commission intends to conduct this exercise taking into consideration the need to achieve the objectives of encouraging growth, maintaining effective investor protection and promoting financial stability. An impact assessment will accompany the relevant delegated acts, being mindful of the cumulative effect and the need to avoid unintended consequences. We would therefore welcome suggestions to this end.

I. Introduction

Article 33(8) of MiFID II sets out that the Commission should adopt delegated acts to further specify the requirements laid down in Article 33(3) which an MTF should comply with when applying for the "SME grow market" (SME-GM) label with its competent authority. These requirements consist of:

- A quantitative criterion as to the minimum proportion of SMEs within the total number of issuers whose financial instruments are admitted to trading on the label applicants (at least 50 %) – this aspect is not discussed in this non paper

- A series of rules to which Member States should submit the label applicants, as a precondition for registering them as SME-GMs, in the following fields:
  - listing criteria (Article 33(3)(b))
  - investor disclosure requirements (prospectus-like) (Article 33(3)(c))
  - transparency of financial reports (Article 33(3)(d))
  - market abuse (Article 33(3)(e) & (g))

The above requirements could be important to ensure the success of the "SME grow market" label, and would need to be calibrated with a view to maintaining a high level of investor protection to promote investor confidence in these markets, ensuring the development of common regulatory standards in the Union for those markets and further fostering and promoting the use of these markets so as to make them attractive to investors, and provide a lessening of the administrative burdens for issuers and further incentives for SMEs to access capital markets through these markets (Recital 132 MIFID II).

II. Options

1. Appropriate criteria for initial and ongoing admission to trading of financial instruments on a SME growth market (Art. 33(3)(b) MiFID II)

ESMA's technical advice - With regard to the criteria that SME-GM should apply for the initial and ongoing admission to trading of financial instruments of SMEs, ESMA considers that it is inappropriate for the implementing measures of MiFID II to prescribe detailed
eligibility criteria (e.g. in relation to an issuer’s corporate governance or framework of systems/controls), since the investor protection objectives of the SME-GM regime can be achieved through a number of different operating models, dependent on local factors, and since the flexibility to choose amongst them is key to accommodate the existing range of successful markets catering for the needs of SMEs. According to ESMA, it is therefore sufficient that the operator of the SME-GM demonstrates to its competent authority that it applies objective criteria which are effective in ensuring that issuers are ‘appropriate’ for admission to an SME-GM.

If ESMA's approach is followed, the determination of the specific admission requirements will rest with the operator of the SME growth market under the supervision of its national competent authority (NCA) and will not aid the development of common regulatory standards in the Union.

**discussion point:** If the objective is to establish common rules to be applied by all the operators of SME-GM and to facilitate multiple secondary listings of SMEs on several EU SME-GMs, will ESMA's approach achieve this?

One way to further achieve this could be to set out quantitative criteria to ensure that there is **sufficient public distribution of the securities** to allow the orderly interaction of supply and demand. This could be done by defining minimum levels of: (i) free float, (ii) initial market capitalisation, (iii) number of investors, and/or (iv) value for any capital raising accompanying an admission. Few of the MTFs which focus on SMEs in the EU currently have explicit requirements in that regard.

More generally, it might be useful to replicate some or all of the minimum conditions for the admission of shares and debt securities set out in Directive 2001/34/EC on the admission of securities to official stock exchange listing (the "Listing Directive"), which currently only apply to the "official listing" of EU stock exchanges. In most Member States, securities traded on MTFs are not admitted to the official list.

The following table summarises the main conditions relating to companies and securities, as set out in the Listing Directive:

<table>
<thead>
<tr>
<th>Specific conditions for the admission to the official listing (Art. 42 – 63, Directive 2001/34/EC)</th>
<th>Admission of shares</th>
<th>Admission of debt securities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Conditions relating to the issuer</strong></td>
<td>♦ Conformity of legal position with laws &amp; regulations (statutes) ♦ Minimum market capitalisation of 1M€* ♦ Published annual accounts for the 3 financial years preceding application to official listing*</td>
<td>♦ Conformity of legal position with laws &amp; regulations (statutes)</td>
</tr>
<tr>
<td><strong>Conditions relating to the securities</strong></td>
<td>♦ Conformity of legal position with laws &amp; regulations ♦ Shares are freely negotiable* ♦ Sufficient number of shares distributed to the public (presumed if free float is at least 25% or if market operates properly with a lower %)</td>
<td>♦ Conformity of legal position with laws &amp; regulations ♦ Debt securities are freely negotiable ♦ Application for admission covers all debt securities ranking pari passu ♦ Amount of loan is at least 200,000</td>
</tr>
</tbody>
</table>
Application for admission covers all the shares of the same class already issued*  
€ (except if tap issues)*  
For convertible/exchangeable debt & debts with warrants: the underlying shares are already listed on a regulated market or admitted simultaneously*  

* Derogations may apply, subject to national discretion.

It should be noted that the Listing Directive grants significant latitude to Member States to derogate from the admission criteria above, based on a national assessment of investor protection and of what may or may not disturb the market.

In addition, proportionality commands that the admission criteria on SME-GM should not be more onerous than those applicable on regulated market, incl. official listings. For instance, while a common minimum free float requirement may foster a level playing field, it would need to be set not too high in order not to discourage SMEs.

**Question:**

Views are welcome as to whether ESMA’s technical advice should be followed, except for §1 p.356 and instead, whether the objective criteria which will ensure that issuers are appropriate for admission to the market, could be achieved by replicating the minimum criteria for admission on the official listing set out in Directive 2001/34/EC, with a special focus on the criteria for sufficient public distribution of securities.

2. **Sufficient information to enable investors’ investment decision in an appropriate admission document, on initial admission to trading of financial instruments on a SME growth market (Art. 33(3)(c) MiFID II)**

**ESMA’s technical advice** - With regards to the content of the admission document in case of initial admission to trading of securities on a SME-GM (where a prospectus is not required), ESMA considers that MTF operators may equally choose to define such a content either by dis-applying specific categories of disclosures required under the prospectus regime (top-down approach) or by setting up a list of minimum information to be included in the admission document (bottom-up approach). According to ESMA, prescribing detailed disclosure requirements is not necessary in Level 2 and should be a matter for market operators to decide, under the supervision of their NCA.

If ESMA’s approach is followed, disclosure requirements will remain un-harmonised across the SME growth markets of the EU, in cases where the Prospectus Directive does not apply. Article 33(7) MiFID II states that a financial instrument admitted to trading on one SME-GM may also be traded on another SME-GM when the issuer has not objected and in such a case the issuer shall not be subject to any obligation relating to corporate governance or initial, ongoing or ad hoc disclosure with regard to the latter SME-GM. From this it can be said that secondary listing opportunities (i.e. SME-GM network) will happen only if there is a certain

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1 “A market operator or investment firm operating an SME growth market should apply a regime of objective criteria which is effective in ensuring that issuers are appropriate for admission to the market.”
level of harmonisation of the obligations relating to corporate governance or initial, on-going or ad hoc disclosure.

**–However, views would be welcome as to whether it is worthwhile** to explore further the possibility to take inspiration from the information requested under the "proportionate disclosure regime" for SMEs and Small Capitalisations under the Prospectus Directive. This could provide a reliable basis for determining which would be the substantial elements of an admission document on a SME-GM, taking into account that SME-GM should not be required to have rules that impose administrative burdens on issuers than are at the same level or greater than those applicable to regulated markets. A starting point for calibrating the content of the admission document would be the proportionate disclosure regime for SMEs and companies with reduced market capitalisation set out in Annexes XXV to XXVIII of the Prospectus Regulation N°809/2004.

**Question:** Should disclosure requirements for the admission to trading of SMEs on a SME growth market include specification of the content of the admission document based on a selection of the most useful information contained in the proportionate disclosure regime for SMEs and companies with reduced market capitalisation set out in Annexes XXV to XXVIII of the Prospectus Regulation N°809/2004?

### 3. Appropriate ongoing periodic financial reporting by or on behalf of an issuer on the market (Art. 33(3)(d) MiFID II)

**ESMA’s technical advice** – Keeping in mind that companies admitted to trading on an MTF are not subject to the Transparency Directive 2004/109/EC ("TD"), ESMA proposes to align the periodic financial reporting requirements applying to issuers traded on a SME-GM with that set out in Article 4 and 5 of the Transparency Directive, as it observes that most venues which currently cater for the SME segment already require the publication of annual and half-yearly reports, which therefore represents an acceptable minimum standard, as well a prevailing best practice.

As to the deadlines for publishing financial reports, ESMA chooses to retain **deadlines** which are less onerous than those imposed by TD on issuers listed on a regulated market: within 6 months after the end of the financial year for the annual financial report (instead of 4 months under TD) and within 4 months after the end of the semester for the half-yearly financial report (instead of 3 months). These deadlines are aligned with those mentioned in Art. 26a(2) of the Prospectus Regulation.

As to the **contents** of the financial reports, ESMA suggests that SME growth markets should not be required by MiFID II Level 2 to impose the use of IFRS on their issuers, which may therefore be allowed to use local financial reporting standards instead. In addition, ESMA reiterates its support to the possibility for MTFs to offer SMEs the option to use the specialised "IFRS for SMEs", a simplified version of the full set of IFRS standards developed by the IASB, which at present does not allow its use by listed companies, irrespective of where they are traded.
What are your views on ESMAs advice? It is useful to investigate further the extension of the "IFRS for SMEs" to SMEs traded on SME growth markets.

4. Compliance of issuers, managers and market operators with the Market Abuse Regulation (Art. 33(3)(e) & (g) MiFID II)

ESMA's technical advice – Given that Regulation N° 596/2014 (MAR) extends the scope of the market abuse framework to financial instruments traded on MTFs, and already contains some measures of proportionality for SME growth markets (namely the option for its issuers to disclose inside information in a simplified way under Art. 17(9) and the exemption from the obligation to draw up an insiders' list, pursuant to Art. 18(6)), ESMA considers sufficient the existing MAR requirements and does not propose any additional or different provision.

Likewise, since the obligations set out in Art. 16 MAR (to establish and maintain effective arrangements, systems and procedures aimed at preventing and detecting insider dealing and market manipulation) apply to investment firms operating an MTF, ESMA considers that no additional specifications at the MiFID level should be implemented for SME growth markets specifically.

Question: What are your views on ESMA's technical advice to deal with the proportionality elements under the relevant MAR implementing measures?
Dear all,

For those interested, and for CMU discussion, I enclose a recently published report by [Title] on how mid-market companies (wherever located) 1) look upon internationalization (45% generate more than half of their revenues internationally, 47% operate in more than 10 countries and 56% say that international growth is a key part of their current strategy), 2) look to finance themselves and their international expansion strategies (58% are most likely to use bank financing, 56% look to internal profits, 31% expect private equity capital to be one of their top funding sources, 22% look to corporate bonds and 21% look to the stock exchange) 3) as well as what they cite as the main reason for a market being seen as the most challenging to do business in (54% cite regulatory or legal hurdles; Next to Asia Pacific, Europe is seen as the most challenging market generally to do overseas international operations in...).

Kind regards,
ESMA Securities Markets Stakeholder Group

Contribution to the Green Paper "Building a Capital Markets Union" (CMU)

In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises' (SME) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium sized companies to have access to funding (through private equity and venture capital funds or through capital markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Preliminary comments

In its initial advice, the SMSG stressed that using capital markets bring many advantages to all companies, especially SMEs, including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they are able to provide (in light of Basel III, possibly the Volcker Rule, the future structure of banking paper etc.) that would make it increasingly more difficult to extend loans to SMEs. The development of the Capital Markets Union may promote alternative funding sources (both equity and debt), to facilitate growth. There is not just one method through which to increase access to funding for non financial companies, including SMEs; fostering a stable, positive environment and incentivising companies through attractive and diverse funding options is essential. In its 2012 report, the SMSG concluded that regulatory initiatives often have a negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that there is a need to focus on how to provide to each category of investors the right incentives to encourage this broad community to invest not only in equity but also in debt issued by smaller companies and how to structure an efficient, transparent and competitive market so that investors can get reliable liquidity in their investments. This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens as individual investors. In addition, the state of development of capital markets, the needs, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed in the EU. It is likewise important that actions focus on the financial sector as a whole and widen and deepen European capital markets, across not only the euro countries, as in the Banking Union, but across all 28 EU Member States, not as a set of silos.

In order to achieve the objectives of the Capital Markets Union, it is essential to develop initiatives to restore investor trust and confidence, in order to revive demand for new sources of funding. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available across Member States.

The Green Paper identifies five priority areas for short term action including the following:
1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;
2. Widening the investor base for SME and improving credit information on SME;
3. Building sustainable securitisation;
4. Boosting long-term investment;
5. Developing European private placement schemes

General comment:
The topics identified are necessary conditions to accelerate integration and try to develop a capital
markets Union.
But the SMG5G thinks, as it is explained in the detailed answers and was stated in previous papers on
SMEs and ESAs review, that on the one side the EU should consolidate successful experiences like MTFs
for equities (AIMs) and bonds (ExtraMOT Pro) rather than running the risk of killing them, and on the
other side there are some important prerequisites:

a) in limited cases there is a need of more EU regulation and less selfishness by member States. NCAs and market participants that shield themselves behind the fact that company law is national: this is a myopic vision to overcome. In order to achieve more integration institutional and retail shareholders should be able to invest easily cross border with similar rights and duties; how can we have a CMU with a shareholder rights directive, imposing detailed rules on even the question to be asked at a general meeting, lacks a EU definition of shareholder (or at least of end-investor) at least for listed companies? How can we achieve CMU and cross-border shareholding when there are financial markets where shares can (or must) still be materialized in paper in order to exercise in a quicker way the right to vote? How can we have a CMU integration when cross border institutional investors do not have common detailed rules on what when and where to disclose major shareholdings due to the weaknesses of the transparency directive. Finally more transparency for listed companies is need at the EU level instead of (or at least before) intrusive EU intervention in the corporate governance of companies; in particular in order to give full information to actual and potential shareholders and to clients of investment funds the full minutes of general meetings must be published by issuers so that all the votes cast by retail and institutional investors are public.

b) in other fields there is a need of less EU regulation and to correct fatal flaws caused by the EU regulation: how can we incentivize cross border raising of capital if equity issuers do depend on NCAs because the home member state is the one where there is the legal seat? Only few companies are able to move to more competitive EU countries. How the EU can facilitate SMEs to depend less on bank and become traded on MTFs if the recent MAR (market abuse Regulation) extend all the listed companies’ reporting requirements (price sensitive information, managers transactions and insider lists) to SMEs on MTFs? A modification of MAR is urgently needed.

c) It is our view that ESMA should be conferred with a wider range of direct supervisory powers where such a transfer of function brings material supervisory efficiencies. ESMA could accordingly be conferred with supervisory competence with respect to systemically important financial institutions (SIFIs) where a clear case has been made, market infrastructures such as trading platforms, central securities depositories, or index providers. A future step (and real milestone) would be to attribute supervisory and non-exclusive competence on all entities with EU-wide reach in order to have a truly European System of Financial “Supervisors”. The Group appreciates that a reform of this nature represents a very significant change to financial market governance in the EU, and that the location of fiscal responsibility, and compliance with the European Court’s Meroni doctrine with respect to which powers can be transferred to EU agencies, must be carefully considered. It also understands that the conferral of direct super-visory power on the European Central
Bank (ECB) under the Single Supervisory Mechanism (SSM) is taking place within a distinct legal framework, reflecting the ECB’s particular legal status under the Treaty. It considers, however, that given that ESMA has shown itself to be a capable supervisor with respect to rating agencies, given the pan-EU systemic risk that certain cross-border actors can generate, and given that the ESA review provides the opportunity to engage in ‘blue-sky’ thinking, that more consideration should be given to how such a transfer of competence might be achieved. Consideration could, for example, be given to whether, given the increasing demands of EU financial market governance, the ESAs should be constituted as EU bodies under the Treaties (necessitating a Treaty amendment).

Unfortunately none of the above five priorities for the short term involves individual investors, except – but probably marginally – ELTIFs. However, the Commission itself rightly points out that “households are the main source of funds to finance investment” (Green Paper on the long term financing of the European economy). Therefore, a successful CMU must involve and attract individual investors. “It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors … The protection of investors should play a major role in building the CMU” (Steven Maijoor, Chair of ESMA). Improving investor protection and clarifying choices for consumers must take a prominent place in the CMU initiatives.

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:

1. The Prospectus regime - lowering barriers to accessing capital markets and the proposals regarding

An effective overall funding environment in Europe must seek to:

- Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.

- Attract a wider set of investors to smaller, growing businesses by reducing the regulatory and fiscal burden on such SME investors.

The SMSG believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no ‘one-size fits all’ solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SMSG SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

- More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.

- Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS) - should be optional for SMEs. In fact nowadays IFRS are compulsory only for consolidated accounts. SMEs typically do not have consolidated accounts but only annual accounts. Today only in very few countries IFRS are used by listed companies for annual accounts and the empirical evidence shows that there are many problems and costs.
Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.

Pre-IPO registration process - prior to the formal offer of securities – would help issuers take advantage of the relatively short term ‘IPO window’. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.

Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and or key adviser. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained.

EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMEs. In its current form, the Prospectus – and in particular the “Summary Prospectus” - is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact. As for more complex products, prospectuses may be replaced by key information documents containing the appropriate level of information.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

Alongside investor interests for standardized credit data, a further focus must be put on taking the interests of small companies and small banks such as savings and cooperative banks into account, i.e. the ones having to provide such data. A European solution for company data needs to be designed in such a way that any provision of data takes place on a voluntary and not a mandatory basis, i.e. only when a company is interested in gaining access to larger and international investor groups in the context of funding measures via the capital markets.

The use of standardized languages like XBRL for the a simplified comparable balance sheet could be an useful as well as the free access to all interconnected business registers.

Valuation: Standardized credit scorings can help to reduce information asymmetries. Though at the same time highly redundant business models based on standardized credit scorings and ratings can lead to significant systemic risks. Therefore investors need also to take on responsibility themselves for adequate risk assessments of their exposure.
3. Securitisation and corporate debt - building debt market financing for SMEs

When exploring the topic of fixed income market financing for SMEs, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an additional definition for the ‘Entreprises de Taille Intermediaire’ which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally. Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies. Further, in the context of the creation of new securities (e.g. private placements), the use of market infrastructures should be promoted, as they increase stability, by using safe, stable and reliable electronic systems, allowing e.g. for notary functions and reconciliation measures (i.e. ensuring integrity of the issue). Services provided by market infrastructures further facilitate an extensive international investors' reach: not only domestic investors are reached, but also investors on a European and global level may be reached. This reduces the “home-bias” phenomenon.

Alongside banks, companies operating in the real economy also make use of asset-backed securities to gain funding on the capital market. Such securities play an important role for companies, offering advantages – alongside being an attractive way of gaining funding – with regard to corporate indicators, credit line utilization and reporting requirements not available when using other capital market products.

Asset-backed receivables in the form of trade, financing or leasing receivables (the latter generally coming from corporate sales funding subsidiaries) are for the most part sold to so-called “asset-backed commercial paper (ABCP) programs” run by banks (“sponsor banks”).

Features of ABCP funding programs:

- Transaction volumes exceeding ca. €15 million; volumes exceeding €300 million may also be run via co-funding structures, in which two or more ABCP programs jointly finance a single pool.
- Liabilities in different currencies or jurisdictions can be bundled (e.g. when including a corporation's foreign subsidiaries in a program);
- With regard to trade receivables, it is common practice to provide coverage via trade credit insurance in addition to structural credit enhancements (e.g. discounts on the purchase price, reserves, etc.).
- ABCP programs bundle the individual transactions, refinancing the total volume through the issue of short-term money-market papers, i.e. the ABCPs.
- The “sponsor banks” additionally provide liquidity lines to their ABCP programs. Their purpose to make liquidity available to the program, should it prove difficult to place sufficient ABCPs on the capital market or should transactions turn out to no longer be suitable for capital markets
(e.g. in cases where the vendor has become bankrupt or other material events),

- Where an ABCP program’s liquidity lines cover not only the dilution risk but also the credit risk, one speaks of “fully-supported programs”; from a structural point of view these contrast greatly to other forms of asset-backed securities.

### Refinancing of SME bank loans through securitisation

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, credit teams for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a show stopper; and the structurally lower visibility of a smaller business a real difficulty.

It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as of end 2012 the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIF report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. Pooling and standardisation of loans is needed to ensure transparency and comparability. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.

#### Corporate bond markets

There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. There are three notable initiatives in Europe of this nature: the Initial Bond Offering launched by NYSE Euronext in 2012, modelled on equity IPOs; the German Bond M market create by the Stuttgart Stock Exchange in 2010; and the LSE ORB market launched in February 2010.
The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of these mixed results.

There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly through the desired expansion of securitisation to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channelling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

4. Boosting Long-term Investments

In its 2012 advice, the SMSG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities, as well as to private equity and venture capital funds. If pension funds covered by IORPDS would also have to comply with Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds’ ability to invest into equity and other long-term assets, but may over time lead to companies being faced with increased costs for pension benefits, as pension funds find it difficult to generate the necessary long-term returns to match their long-term liabilities.

Given the plethora of investment funds in Europe (33000 versus 8000 in the US which is a more than twice bigger market), it will be difficult to justify the addition of yet further additional categories of long term funds such as European Long Term Investment Funds (ELTIFs), European Venture Capital (EuVECA) and European Social Entrepreneurship Funds (EuSEF), and of a Pan-European personal pension plan ("29th regime") on the EU market, unless the industry and/or the regulators start streamlining, standardising and simplifying the other long term funds and individual investment product offerings. For example, in France alone, there are already nine long-term AIFs legal categories, most of which are marketed to individual investors, all with special tax provisions.

1 FCPR, FCPI, FCPE, FIP, OPCI, SICAF, SICAV-AS, SCPI, SPPICAV
For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldschein) providing approximately €15 billion of debt in 2013.

The German Schuldscheindarlehen Market has a remarkable volume: EUR 68.7 bn with new issuance in 2014 of EUR 11.7 bn shows that Schuldscheindarlehen are a set financing instrument for especially medium sized enterprises (ca. 60% are non-listed companies) which should be considered as reference when thinking about European solutions. Investors have a buy and hold perspective which is also reflected in the average maturity (5.3 yrs).

It’s long track record with very low default rates and the required legal certainty makes the Schuldscheindarlehen an attractive asset class for investors.

These markets provide financing through the use of so called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets. This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be “privately placed” to individual or small groups of institutional investors as in the case for example of reverse enquiry EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the European Private Placement Association (EU PPA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

Any increase in transaction costs, for example through further transparency requirements or an extension of the framework – like the LMA/ICMA standard requires –, would make access to this funding instrument more difficult for SMEs.

This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements. Most recently the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:
• Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.

• The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.
Detailed response to the Commission's Green Paper

Improving SME access to finance:

The Green Paper's analysis:
- for SMEs: diversity and scant credit information, preference to relationship based lending (hence banks);
- for start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring
- for mid-caps: access to public markets is costly
- Corporate bond markets lack transparency and standardisation
- Crowdfunding remains focused on national markets

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

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures¹:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME's access to finance and investor’s ability to invest.
- "Regulatory reconciliation": is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e. g. CRD IV/CRR, MiFID II/MiFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.
- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them. Initiatives to promote financial literacy, to develop a capital market culture and to revive investor trust are needed.
- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.

- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital and other early stage fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.
- Creation of public support specific to these companies (for example, subsidized credit lines).
- Commissioning a comparative review of the EU and US high yield debt markets with a specific focus on providing investors access to smaller companies at mutually attractive terms.
- Developing a flexible EU “bankruptcy regime” (similar to the Chapter 11 provisions in the US). Further harmonisation/standardisation/removal of barriers.

  In addition the following tax incentives could be considered: If start-ups were allowed to off-set eg social charges against their tax-loss carry forwards which they typically accumulate during their early years of existence rather than eventually selling them off to a more mature company (who will use them to off-set tax on corporate profits), this would help reduce their overall funding needs in the beginning while allowing them to employ staff during critical growth stages of their development.

- Revive individual investors’ involvement in equity markets: in 1970 individual investors held directly close to 40 % of EU listed companies, compared to about 13 % today.
- Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment products by standardising, simplifying, streamlining and reducing the cost of - packaged investment products.

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?

When SMEs decide to use rating agencies, incentives, also for corporate debt rating, could be considered as follows:

- Reducing information asymmetries between issuers and investors and, as such, the risk premium demanded on loans to SMEs.
- Protecting investors, through the provision of additional information about the additional risks they are incurring with these types of investments.
- Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by recognized External Credit Assessment Institution (ECAI).
- Reducing costs by making the assets accepted as collateral in liquidity-providing operations to banks by the ECB, if the ratings are issued by recognized ECAI.

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

There should be two separate types of ELTIFs, those catering for the needs of institutional investors and those catering for the needs of retail investors. If all ELTIFs are modelled on the needs of retail investors (liquidity; investor protection etc) it risks making them unnecessarily expensive for the institutional investors.
Any successful development of ELTIFs should consider:

- eliminating the plethora of already existing long term fund categories which are nationally incentivised (nine such categories existing in France alone, all with tax incentives).
- Granting the “most favoured nation” clause to ELTIFs for its tax treatment in Member States
- Selling the same ELTIFs to all investors – retail or not, and ban funds of funds which add a layer of fees
- Applying the product disclosure rules of UCITS funds;
- Making listed small cap equity an eligible asset class.
- allowing as well closed-end listed ELTIFs to address the liquidity issue
- Setting a high threshold for minimum investments in ELTIFs: those should be “advised” only to qualified and very financially literate investors.

Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFs can play an important role in capital market funding in the EU, but they need more official support. One of the major barriers ELTIFs will face in trying to develop into a genuine cross-border fund structure, with a UCITS-like passport, is the lack of a level playing field for non-bank providers of credit when compared to bank lenders. Because ELTIFs are intended to invest in illiquid, often private (as opposed to public) assets, ELTIFs may need to operate only nationally if at all, given the various national restrictions on banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFs, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

- the inability of funds to originate loans;
- the need for a banking licence to originate loans;
- bank liabilities preferred on bankruptcy;
- the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
- restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
- different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

EU could undertake a review of the current obstacles to cross-border fundraising which have eg arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.

In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Corporate Private Placement Market Guide published on 11 February 2015), we suggest that a
revision of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation [EU] 2015/35) should be considered. Although the final calibrations in the Delegated Act (the “long term guarantees package”) has helped remove obstacles to investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investment in private placements, as well as more generally in long-term assets.

Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

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

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, e.g. rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.

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?

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets. It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bonds markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues
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?

As a preliminary comment, it is important to note that green bonds like any other listed bond come under the scope of existing financial regulation both at the EU and national levels. Green bonds are therefore not being issued in any form of regulatory void. They also benefit from a successful self-regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process represented by the GBP is preferable to a top-down normative approach leading for example to a green bond “label” formally recognized at a regulatory level. This would risk creating unnecessary market segmentation, as well as the perception of potential liabilities for issuers that could dissuade them from entering the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond market as they both experience additional costs compared to mainstream alternatives, and/or in order to maintain or accelerate the development of the market in support of wider public policy objectives related especially to the fight against climate change. The GBP require additional work from green bond issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g. dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green bonds and the underlying environmental projects. These costs are not reflected in the economics of green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal identified above of avoiding a top down normative approach to these securities.

At this stage, it is therefore most likely preferable to allow the green bond market to continue its development based on its current strong momentum and successful self-regulation (within the safeguards provided by mainstream financial regulation). An active dialogue can be maintained on the need for possible future incentives between the Commission and national authorities on the one hand, and industry associations and self-regulatory initiatives on the other.

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

The ESMA SMSG is in favour of the distinct and separate SME market regime under MiFID II and MAD

The SMSG believe that such a regime would have the following benefits:
recognise the role such markets currently play in the EU funding environment;
ensure that changes to EU financial services regulation do not adversely impact small caps;
cater for a secondary market for trading shares of less liquid SMEs;
allow for further development of regulatory and fiscal EU policies to attract investors to this asset class.

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 one of the emerging financing models that contribute to helping start-ups move up the "funding escalator", as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refers to open calls to the wider public to raise funds for a specific project. These calls are often published and promoted through the internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds

- Non financial crowdfunding, includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- Financial crowdfunding, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, Understanding Alternative Finance, Peter Baeck, Liam Collins, Bryan Zhang, November 2014 ) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.

Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects raise funds are themselves also relatively small business. According to the same Nesta report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200.000 pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no
previous investment experience. Estimation of activity for the European Union is not easy, and overall figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax reliefs to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, rising awareness, etc.) addressed at promoting its usage as a financing vehicle. ESMA recently published an Advice on Crowdfunding to European Parliament, Council, and Commission taking into account the need of promotion and clarification, while at the same time preserving investor protection at its highest level.


The main objective of the report is to assist NCA’s and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.

Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is pure reception and transmission of orders, in which case a 50,000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission’s programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU–based platforms that could compete with the US ones.
Supply side: institutional investors

The Green Paper’s analysis of current regulation and tools
UCITS V and AIFMD
• The directives are still insufficient to reduce cost and diversify managed funds investment.

On pensions and insurance:
• There could be a review of Solvency II (and CRR) delegated acts, to adapt prudential rules for identified sub-classed of lower-risk infrastructure investment.
• The Commission asks which sub-classes should be prioritised for.

On professional pensions:
• Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

Private equity and venture capital:
• EuVECA and EuSEF Regulations - the clause impeding managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
• Commission asks which measures could be proposed to increase scale of venture capital funds (both via public and private contributions, improve exit strategies and supply for investors and boost supply of venture capital to start ups.

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as these funds are typically closed-ended and unleveraged; if not - the €100 m threshold would apply ) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. However, the potential to be caught by AIFMD will ‘deter’ funds from gaining scale which is ultimately needed to allow a fund to diversify and achieve attractive returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds >€100m compared to 227 in the US. The SMSG is aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequences in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive.

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU countries there are still institutional barriers to larger investments by eg pension funds, insurance funds

1 Earlybird Europe Venture Capital Report – July 2011
etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so
called prudent person rules.

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?

Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a
more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given
the lower liquidity of the underlying assets.

There are 33,000 funds in the EU versus 800 in the US. The average size of an EU fund is about €200
million versus €1,600 million in the US, i.e. 8 times bigger. The annual fees of EU equity funds are 1701

12) Should work on the tailored treatment of infrastructure investments target certain clearly identif-
iable 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?

EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any
future proposals to introduce similar regulation for pension funds must not place conditions that ad-
versely impact the ability to directly or indirectly invest in small caps. The capital and liquidity require-
ments under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest
and most liquid blue-chip equities or even only interest bearing instruments like government bonds due to
the lower risk weightings for these than equities in general and deter any existing appetite for smaller
companies. An appropriate exemption for direct or indirect investment in small cap securities should be
implemented.

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

The European Venture Capital Funds Regulation (EVCFR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes holdings in SME markets as ‘qualifying portfolio companies’. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest Institutions do) nor have necessarily worked in the financial industry.

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?

As mentioned above through not imposing overly restrictive capital requirement, not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class. Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor. Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company’s development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the “valley of death”...

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

- Commission asks how to increase participation in UCITS by cross-border retail;
- Share best national best practices in the development of simple and transparent investment products for consumers;
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

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

Review of UCITS directive to identify ways to attract dedicated UCIT funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the advantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make investments directly in SME issuers.

UCITS are much more cross-border than AIFs already because the two major domiciles for UCITS are largely “off-shore”: Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross-border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).

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

ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better enforce existing investor protection rules. For all this they need their resources to grow, not to be cut.

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

General comment

The savings rate of household is already quite high in Europe. Also, contrary to what one often reads, individual investors are not more short term nor more risk averse than other investors:

- 62% of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80% of their total savings are long term if property is taken into account.
DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least).

By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8% from 2001 to 2010: way before Solvency II.

The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.

The involvement of individual investors in SME markets is about twice as large as it is in blue chips.

What individual investors do not like is high risk – low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the first category returned a net real after tx return of 20% since 2000, the latter a negative one of minus 14% over the same period.

- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

- Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMES, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.

- Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected they will be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders’ voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.

- Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.

- Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.

- One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are eg incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax deductible expenses for a company and then taxed in the hands of the recipient, divi-
dends are subject to double taxation (made out of taxed corporate profits and then taxed again in the
hands of investors).

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

To our knowledge, the longer term the retail investment products are the more complex. This is why a
simple, standardized Pan-European personal pension plan is needed.

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?

Yes:
- The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further
  standardise and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance
  Mediation and IORP Directives should be amended in order to make their summary documents more
  standardised, simpler, shorter, in Plain English and more comparable between each other and with other
  investment products.
- IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights
  cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely
  associate and for these shareholder association to easily collect proxies from their members.
Supply side – non-EU investment

Attracting non-EU investment:

• The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
• The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

EU needs to continue to ensure “reciprocity”, ie not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market internationally.

Given that many regulatory initiatives are newly implemented in Europe, and taking into account that markets have become global, the topic of third-country recognition is important. In general, the same level of requirements for third-country enterprises providing their services in a European Member State should be maintained in order to preserve the desired standards of services in the EU. The potentially lower standards from third countries for the same services should not be introduced via recognition procedures. This is particularly sensitive with regard to foreign competition, affecting the growth potential for EU companies.

Therefore, a fair balance needs to be found to allow non-EU companies to provide their services in Europe.

It is important to ensure that global standards and rules put in place by institutions such as the International Organization of Securities Commissions, the Bank for International Settlements and the Financial Stability Board are carefully considered when drafting regulation in order to avoid regulatory arbitrage that could have negative consequences for growth. Safety standards, risk mitigation measures and data protection rules, for example, should be put in place at the highest level possible. A “race to the bottom” should be avoided, so that individual players cannot exploit weak regulatory regimes. Isolated national regulation should be avoided as well.

On the other hand, it is important that European companies are allowed to enter third country markets to provide services abroad. It should be noted that other countries may have high barriers of access to their markets, which is another reason to consider initiatives to ensure that EU market participants are able to offer their services outside the EU on a level playing field with non-EU providers.

In this regard, reciprocity should be requested and maintained with regard to third-country regimes.

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?
Improving the investment chain

Commission’s analysis regarding the single rule book, enforcement and competition includes:

- The single rulebook is a major step forward to enforce EU regulation consistently but the single rule book’s success depends on consistent implementation and enforcement.
- Supervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
- Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
- Market infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

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

Regulatory reconciliation is a key in the next years.

The Capital Markets Union should ensure that the long-term goal is to reduce the regulatory burden to what is essential. Additionally, loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences.

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?

Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to “crack-down” on national CAs who go further than what has been envisaged under certain Directives?

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?

The overall legal framework for securities varies widely by country. For example, legal barriers make it much more complex to hold securities cross-border, and lead to higher costs for transactions. In addition, they cause difficulties and uncertainty among investors when they exercise their rights abroad.

Given that legal uncertainty of this nature acts as a barrier to financial stability and growth, the European Commission has been examining barriers within securities markets for several years, with the aim of creating a stable and efficiently functioning single market.

Continued harmonisation of rules and standards is essential to eliminate costly barriers and reduce complexity for investors and companies. Initiatives in this area, building on the Single Rulebook as a harmonised regulatory framework, should increase the attractiveness and returns on investment, thereby stimulating economic growth.
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?

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?

Without common applied corporate governance principles/control the Union cannot be done successfully. Thus further harmonisation of national rules and standards are needed in order to eliminate costly barriers and reduce complexity for investors is essential.

The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and size) company statutory reporting info for the last 12 years is available (for purchase) via the web-site www.allabolag.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

Language is another impediment.

Despite significant progress towards the European single market, capital markets are still fragmented with regard to company law, corporate governance rules, creating barriers that hamper the free flow of capital. Those barriers across regions make cross-border investments complex and expensive, and therefore less attractive. The Single Rulebook has not yet been fully achieved.

Continued harmonisation of national rules and standards in order to eliminate costly barriers and reduce complexity for investors is essential.

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

Different national insolvency laws make cross-border services expensive. Reducing the existing inefficiencies will play an important role in unleashing the wider macroeconomic benefits from integrating European securities markets.

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?

- Eliminate the double taxation of cross-border dividends and interests within the EU and end tax discriminations against EU investors domiciled in another Member state than the investment provider.

- Review of EU State Aid risk capital guidelines to allow for effective incentive schemes to be adopted by Member States. The guidelines should recognise the role of expansion capital as genuine risk capi-
Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Exemption of certain investment rules imposed on certain investors in the case of investments in SMEs (e.g., minimum ratings, liquidity of securities, etc.). This would need to be balanced with any risk of misallocation of capital.

The Financial Transaction Tax, would increase transaction costs in European financial centres and could therefore impede the goals of the Capital Markets Union. SMEs in particular would face higher capital raising costs as a result of rising transaction costs. Retail investors would also suffer greater financial losses as the tax directly hits retirement provision products. Further, if the financial transaction tax, is introduced in 11 Member States this contradicts the harmonisation intentions within the European Union. However, if introduced, it should not apply to SME transactions. Given that investors in smaller companies usually require a higher rate of return on investment, an additional tax would have a disproportionate increase in the cost of capital for smaller companies and is likely to deter investors from this asset class.

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?

MIFID has posed serious challenges to the bank and broker intermediation chain potentially harming local funding ecosystems

With regard to Regulated Markets and MTFs, the increased transparency included in regulation such as MiFID represents a challenge for SMEs, resulting in a suboptimal time allocation for SMEs’ board and management and ensuing increased costs of accessing public markets. In addition, MiFID has also heightened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the Uk in 2014, where it now counts 33 participants.

Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a “work zone” supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is “capital neutral” to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.
It is made up of different phases:

- **1° phase - GET READY**: It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities.

- **2° phase - GET FIT**: New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support, where appropriate, of a dedicated external advisory team.

- **3° phase – GET VALUE**: Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European ELITE community of advisers, investors and stakeholders.

Elite was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the UK in 2014, where it now counts 33 participants. In December 2014 Borsa Italiana and the London Stock Exchange Group have presented the imminent launch of a Europe-wide Elite program at the European Parliament; it will be a European platform deeply rooted in each domestic market, through partnerships with local institutions enabling companies to access support and advice throughout Europe.

- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.

- Transaction costs should be lowered towards the US level.

- Actual **consolidated tape** – free for individual investors after a few minutes – should be now eventually enforced in Europe. A debate on the consolidated tape, as included in the data and reporting section, should be addressed within MiFID II. Article 90.2. MiFID II even includes a review clause for the CTP regime. To avoid double regulation, its strongly recommended to delete the part on consolidated tape.
We will have time to discuss this and more tomorrow, but I believe we need also to differentiate between investing (for the longer term) and trading when looking at eg the FTT.

Kind regards,

Dear friends, from my side congratulations to all those who have contributed to this excellent draft. Some additional reflections on which I am quite willing to elaborate tomorrow (with apologies for the late input)

It is quite likely that bank loans will remain an important source of SME finance. Hence the importance of securitisations of SME loans but also the possibility to wrap loans into funds (which could be relevant for integrated financial institutions which encompass both a bank and an asset manager). At the same time, there is a link with the issue of credit information, as banks will have assessed the creditworthiness before granting loans, and this assessment is in itself a potential source of credit information (but not public)

As such, I would like to reiterate an issue that I raised before in the context of transparent securitisations. One of the requirements for transparent securitisations should be information on the origination of the underlying loans and the associated credit granting process. This is a point that could be relevant both for paragraph on 'credit information' on SME's (how were underlying loans granted) and for the paragraph on securitisation.

Also, there could be a link to the topic of reducing reliance on external ratings. To the extent that banks have an internal credit assessment process which is deemed reliable, there would be less need for SME's which want to have an external rating in order to have their loans securitised. A reference to the internal credit assessment process of the bank would do the job.
Another remark refers to the issue of FTF. While I could support the idea that if a FTF were introduced, it should not be applicable to SME finance and while I fully understand the technical problems, including finding the right balance, associated with FTF, I have some problems with disavowing the principle of FTF as a whole. If I buy a car, or a beer, or a house, or whatever, all these things will be made more expensive to me due to VAT. As far as I know, there is no VAT on financial transactions (please correct me if I am mistaken). However, does that mean that there should be no tax at all on financial transactions? While I do not want to convince other members of my view, I would ask, if a text in this sense were to be accepted, that a reference to a divergent opinion be included.

Best regards, see you all tomorrow

Verstuurd vanaf mijn iPad

> 
> [Redacted]
>
> Please find attached some further comments on the CMU paper for
> consideration. Apologies for the late input.
> I look forward to seeing you all in Paris.
>
> Many thanks
>
> [Redacted]
>
> (See attached file: 20150413_SMSG Comments on Text.doc)
>
> ______________________________________________
> ------
Dear Members of the SMSG,

Please find attached the final agenda.

Secondly for agenda point 3 please find the draft CMU paper previously circulated, and including comments made. On behalf of please note that the inclusion of the various comments in the draft are made solely to reflect the points made by members in order to provide an overview and does not in any way represent what the final paper will look like; that will be discussed at meeting.

Finally for agenda point 8, please find the ESMA consultation paper on complex products and structured deposits.

Kind regards,

Dear all,

Please find attached comments from my side.
I would like to thank [Redacted] and all SMSG colleagues your input.

With kind regards,


Dear all,
As promised, I am sending you herewith our (Draft) contribution to the Commission Green Paper “Building a Capital Markets Union” (CMU).
I am including herewith both the clean version and a tracked changed version taking into account only the comments received in track version.
I am also including the power point presentation as well as a quick summary of our key opinions (as requested by [Redacted]) which I hope you will find useful.
Please remember that our contribution should be based on our institutional role as advisor to ESMA and that therefore our input should be high-level and strategic.

Next steps and deadlines:
• Please send your written comments by 23 April. Please write directly in the draft using a track change to facilitate the drafting of the final document.
• Steering committee to review overall coherence and distribute the final document for approval on Thursday 30 April
• Green Paper consultation Deadline: 13 May 2015

Kind regards,

[Blank]

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Subject: RE: SMSG - CMU
Dear all,
I am sending you herewith the contribution of the SMSG to the Commission Green Paper "Building a Capital Markets Union" (CMU). I am including both a clean version and a tracked changed version taking into account all comments received as far as possible (given the relatively late input for some contributions).

Please note that the document is structured into three distinct parts:
• The SMSG’s preliminary comments
• The SMSG’s comments on the Commission’s 5 priorities for short terms action (prospectus regime; SME credit scoring; securitisation; long-term investment and private placement)
• The SMSG’s detailed comments on the Green Paper’s questions

We have set aside 2 hours tomorrow morning to discuss the document.
Please note that I will make a power presentation trying to summarise our current draft position. That’s quite a challenge given the breadth of issues that we are trying to cover!
See you tomorrow!

Kind regards,

[Blank]
Dear all,

Apologies for another memo to read as background on the CMU, but attached is a fairly technical internal briefing document we have put together on the subject of market structure for SME Growth Markets and as well as less liquid securities. Hopefully you might find it interesting in the overall CMU context.

See you tomorrow.

Yours

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ESMA Securities Markets Stakeholder Group

Contribution to the Green Paper “Building a Capital Markets Union” (CMU)

In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises’ (SME) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium sized companies to have access to funding (through private equity and venture capital funds or through capital markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Preliminary comments

In its initial advice, the SMSG stressed that using capital markets bring many advantages to SMEs including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they are able to provide (in light of Basel III, possibly the Volcker Rule, the future structure of banking paper etc.) that would make it increasingly more difficult to extend loans to SMEs. The development of the Capital Markets Union may promote alternative funding sources (both equity and debt), to facilitate growth. There is not just one method through which to increase access to funding for SMEs: Fostering a stable, positive environment and incentivising companies through attractive and diverse funding options is essential. In its 2012 report, the SMSG concluded that regulatory initiatives often have a negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that there is a need to focus on how to provide to each category of investors the right incentives to encourage this broad community to invest not only in equity but also in debt issued by smaller companies and how to structure an efficient, transparent and competitive market so that investors can get reliable liquidity in their investments. This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens as individual investors. In addition, the state of development of capital markets, the needs, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed in the EU. It is likewise important that actions focus on the financial sector as a whole and widen and deepen European capital markets, across not only the euro countries, as in the Banking Union, but across all 28 EU Member States. not as a set of silos.

In order to achieve the objectives of the Capital Markets Union, it is essential to develop initiatives to restore investor trust and confidence, in order to revive demand for new sources of funding. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available across Member States.

The Green Paper identifies five priority areas for short term action including the following:
1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;
2. Widening the investor base for SME and improving credit information on SME;
3. Building sustainable securitisation;
4. Boosting long-term investment;
5. Developing European private placement schemes

General comment:
Unfortunately none of these five priorities for the short term involves individual investors, except – but probably marginally – ELTIFs.
However, the Commission itself rightly points out that “households are the main source of funds to finance investment” [Green Paper on the long term financing of the European economy]. Therefore, a successful CMU must involve and attract individual investors. “It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors ... The protection of investors should play a major role in building the CMU” (Steven Maijoor, Chair of ESMA). Improving investor protection and clarifying choices for consumers must take a prominent place in the CMU initiatives.

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:

1. The Prospectus regime - lowering barriers to accessing capital markets and the proposals regarding

An effective overall funding environment in Europe must seek to:

- Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.
- Attract a wider set of investors to smaller, growing businesses by reducing the regulatory and fiscal burden on such SME investors

The SMSG SME believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no ‘one-size fits all’ solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SMSG SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

- More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.
- Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS) - should be optional for SMEs.
- Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.
- Pre-IPO registration process - prior to the formal offer of securities – would help issuers take advantage of the relatively short term ‘IPO window’. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.

- Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and or key adviser. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained.

- EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMEs. In its current form, the Prospectus – and in particular the “Summary Prospectus” - is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

Alongside investor interests for standardized credit data, a further focus must be put on taking the interests of small companies and small banks such as savings and cooperative banks into account, i.e. the ones having to provide such data. A European solution for company data needs to be designed in such a way that any provision of data takes place on a voluntary and not a mandatory basis, i.e. only when a company is interested in gaining access to larger and international investor groups in the context of funding measures via the capital markets.

Valuation: Standardized credit scorings can help to reduce information asymmetries. Though at the same time highly redundant business models based on standardized credit scorings and ratings can lead to significant systemic risks. Therefore investors need also to take on responsibility themselves for adequate risk assessments of their exposure.

3. Securitisation and corporate debt - building debt market financing for SMEs

When exploring the topic of fixed income market financing for SMEs, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an addi-
tional definition for the ‘Entreprises de Taille Intermediaire’ which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally.

Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies. Further, in the context of the creation of new securities (e.g. private placements), the use of market infrastructures should be promoted, as they increase stability, by using safe, stable and reliable electronic systems, allowing e.g. for notary functions and reconciliation measures (i.e. ensuring integrity of the issue). Services provided by market infrastructures further facilitate an extensive international investors’ reach: not only domestic investors are reached, but also investors on a European and global level may be reached. This reduces the “home-bias” phenomenon.

Alongside banks, companies operating in the real economy also make use of asset-backed securities to gain funding on the capital market. Such securities play an important role for companies, offering advantages – alongside being an attractive way of gaining funding – with regard to corporate indicators, credit line utilization and reporting requirements not available when using other capital market products.

Asset-backed receivables in the form of trade, financing or leasing receivables (the latter generally coming from corporate sales funding subsidiaries) are for the most part sold to so-called “asset-backed commercial paper (ABCP) programs” run by banks (“sponsor banks”).

Features of ABCP funding programs:

- Transaction volumes exceeding ca. €15 million; volumes exceeding €300 million may also be run via co-funding structures, in which two or more ABCP programs jointly finance a single pool.
- Liabilities in different currencies or jurisdictions can be bundled (e.g. when including a corporation’s foreign subsidiaries in a program).
- With regard to trade receivables, it is common practice to provide coverage via trade credit insurance in addition to structural credit enhancements (e.g. discounts on the purchase price, reserves, etc.).
- ABCP programs bundle the individual transactions, refinancing the total volume through the issue of short-term money-market papers, i.e. the ABCPs.
- The “sponsor banks” additionally provide liquidity lines to their ABCP programs. Their purpose to make liquidity available to the program, should it prove difficult to place sufficient ABCPs on the capital market or should transactions turn out to no longer be suitable for capital markets (e.g. in cases where the vendor has become bankrupt or other material events),
- Where an ABCP program’s liquidity lines cover not only the dilution risk but also the credit risk, one speaks of “fully-supported programs”; from a structural point of view these contrast greatly to other forms of asset-backed securities.
Refinancing of SME bank loans through securitisation

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, credit teams for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a show stopper; and the structurally lower visibility of a smaller business a real difficulty.

It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as of end 2012, the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIF report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. Pooling and standardisation of loans is needed to ensure transparency and comparability. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.

Corporate bond markets

There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. There are three notable initiatives in Europe of this nature: the Initial Bond Offering launched by NYSE Euronext in 2012, modelled on equity IPOs; the German Bond M market create by the Stuttgart Stock Exchange in 2010; and the LSE ORB market launched in February 2010.

The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of these mixed results.
There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly though the desired expansion of securitisation to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channelling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

4. Boosting Long-term Investments

In its 2012 advice, the SMSG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities as well as to private equity and venture capital funds (and other illiquid long term assets). If pension funds covered by Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds’ ability to invest into equity and other long-term assets, but could also time lead to companies being faced with increased costs for pension benefits, as pension funds would find it difficult to generate the necessary long-term returns to match their long-term liabilities.

5. Developing a European Private Placement scheme

For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldschein) providing approximately €15 billion of debt in 2013.

The German Schuldscheindarlehen Market has a remarkable volume: EUR 68.7 bn with new issuance in 2014 of EUR 11.7 bn shows that Schuldscheindarlehen are a set financing instrument for especially medium sized enterprises (ca. 60% are non-listed companies) which should be considered as reference when thinking about European solutions. Investors have a buy and hold perspective which is also reflected in the average maturity (5.3 yrs).

It’s long track record with very low default rates and the required legal certainty makes the Schuldscheindarlehen an attractive asset class for investors.
These markets provide financing through the use of so called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets. This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be “privately placed” to individual or small groups of institutional investors as in the case for example of reverse enquiry EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the Euro Private Placement Association (EU PPA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

Any increase in transaction costs, for example through further transparency requirements or an extension of the framework – like the LMA/ICMA standard requires –, would make access to this funding instrument more difficult for SMEs.

This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements. Most recently the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:

- Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.
- The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.
Detailed response to the Commission’s Green Paper

Improving SME access to finance:

The Green Paper’s analysis:

- for SMEs: diversity and scant credit information, preference to relationship based lending (hence banks);
- for start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring
- for mid-caps: access to public markets is costly
- Corporate bond markets lack transparency and standardisation
- Crowdfunding remains focused on national markets

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

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME’s access to finance and investor’s ability to invest.
- “Regulatory reconciliation”: is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e.g. CRD IV/CRR, MiFID II/MiFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.
- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them. Initiatives to promote financial literacy, to develop a capital market culture and to revive investor trust are needed.
- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.

• Review of categorisation of high net worth individuals/business angel type investors and other investors such as local and regional associations or small pension plans – that have the capacity to lock up some of their capital for a period and to diversify their portfolio beyond cash and high liquid securities. The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital and other early stage fund managers (and their end investors) in the AIFMD and the EuVECA, EuSEF and ELTIF passporting schemes.

• Creation of public support specific to these companies (for example, subsidized credit lines).

• Commissioning a comparative review of the EU and US high yield debt markets with a specific focus on providing investors access to smaller companies at mutually attractive terms.

• Developing a flexible EU “bankruptcy regime” (similar to the Chapter 11 provisions in the US). Further harmonisation/standardisation/removal of barriers.

In addition the following tax incentives could be considered: If start-ups were allowed to offset social charges against their tax-loss carry forwards which they typically accumulate during their early years of existence rather than eventually selling them off to a more mature company (who will use them to offset tax on corporate profits), this would help reduce their overall funding needs in the beginning while allowing them to employ staff during critical growth stages of their development.

• Revive individual investors’ involvement in equity markets: in 1970 individual investors held directly close to 40 % of EU listed companies, compared to about 13 % today.

• Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment products by standardising, simplifying, streamlining and reducing the cost of - pack-aged investment products.

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?

When SMEs decide to use rating agencies, incentives, also for corporate debt rating, could be considered as follows:

• Reducing information asymmetries between issuers and investors and, as such, the risk premium demanded on loans to SMEs.

• Protecting investors, through the provision of additional information about the additional risks they are incurring with these types of investments.

• Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by recognized External Credit Assessment Institution (ECAI).

• Reducing costs by making the assets accepted as collateral in liquidity-providing operations to banks by the ECB, if the ratings are issued by recognized ECAI.

3) What support can be given to ELTIFs to encourage their take up?
There should be two separate types of ELTIFS, those catering for the needs of institutional investors and those catering for the needs of retail investors. If all ELTIFS are modelled on the needs of retail investors (liquidity; investor protection etc) it risks making them unnecessarily expensive for the institutional investors.

At the same time a single set of rules for all types of investors (retail; or professional small; medium; large) will fail to recognize different needs of such a wide range of investors or of a wide range of eligible assets. ELTIFS seek to attract. Therefore, the possibility to adapt the structure on the different needs of the investors' base of each ELTIF is necessary to increase their market attractiveness and finally their success in financing of the long-term needs for growth of the EU economy.

The discretion of the asset manager to choose whether to open the ELTIF to retail investors or not along with the discretion as to the portfolio composition and the early redemption rights are welcome. Still, additional effort should be made to attract particular categories of investors such as Small pension plans and local associations that have the capacity or are sometimes even required to lock up some of their capital for a period and to diversify their portfolio beyond cash and high liquid securities. As those investors are classified as retail investors they will be excluded from a number of ELTIFS open only to professional investors. Moreover, investors need and seek stable environments. Ensuring that substantial incentives are in place includes also the provision of tax incentives and the removal of any fiscal or administrative barriers. Moreover, investors need and seek stable and predictable regulatory environments. This prerequisite becomes even more relevant in the case of long-term illiquid investments, in which the link to a particular jurisdiction is of longer duration. Finally, education and training for retail investors will help them understand the risks associated with the financing of a long-term project and the economic and social benefits.

Any successful development of ELTIFS should consider:

Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFS have the potential to play an important role in capital market funding in the EU. If the right incentives are in place. Because ELTIFS are intended to invest in illiquid, often private (as opposed to public) assets, particular attention should be paid to national restrictions and barriers deriving from banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFS, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

- the inability of funds to originate loans;
• the need for a banking licence to originate loans;
• bank liabilities preferred on bankruptcy;
• the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
• restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
• different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

EU could undertake a review of the current obstacles to cross-border fundraising which have eg arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.

In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Corporate Private Placement Market Guide published on 11 February 2015 ), we suggest that a revision of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation (EU) 2015/35) should be considered. Although the final calibrations in the Delegated Act (the “long term guarantees package”) has helped remove obstacles to investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investment in private placements, as well as more generally in long-term assets.

Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

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

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, e.g. rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.
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?

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets. It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bonds markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues from the rest of the sector could come to resemble the more bespoke private placement market, on the other hand.

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?

As a preliminary comment, it is important to note that green bonds like any other listed bond come under the scope of existing financial regulation both at the EU and national levels. Green bonds are therefore not being issued in any form of regulatory void. They also benefit from a successful self-regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process represented by the GBP is preferable to a top-down normative approach leading for example to a green bond “label” formally recognized at a regulatory level. This would risk creating unnecessary market segmentation, as well as the perception of potential liabilities for issuers that could dissuade them from entering the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond market as they both experience additional costs compared to mainstream alternatives, and/or in order to maintain or accelerate the development of the market in support of wider public policy objectives related especially to the fight against climate change. The GBP require additional work from green bond
issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g. dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green bonds and the underlying environmental projects. These costs are not reflected in the economics of green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal identified above of avoiding a top down normative approach to these securities.

At this stage, it is therefore most likely preferable to allow the green bond market to continue its development based on its current strong momentum and successful self-regulation (within the safeguards provided by mainstream financial regulation). An active dialogue can be maintained on the need for possible future incentives between the Commission and national authorities on the one hand, and industry associations and self-regulatory initiatives on the other.

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

The ESMA SMSG is in favour of the distinct and separate SME market regime under MiFID II and MAD

The SMSG believe that such a regime would have the following benefits:

- recognise the role such markets currently play in the EU funding environment;
- ensure that changes to EU financial services regulation do not adversely impact small caps;
- cater for a secondary market for trading shares of less liquid SMEs;
- allow for further development of regulatory and fiscal EU policies to attract investors to this asset class.

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 one of the emerging financing models that contribute to helping start-ups move up the “funding escalator”, as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refers to open calls to the wider public to
raise funds for a specific project. These calls are often published and promoted through the internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds.

- Non financial crowdfunding, includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- Financial crowdfunding, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, Understanding Alternative Finance, Peter Baeck, Liam Collins, Bryan Zhang, November 2014) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.

Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects raise funds are themselves also relatively small business. According to the same Nesta report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200,000 pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no previous investment experience. Estimation of activity for the European Union is not easy, and overall figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax reliefs to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, rising awareness, etc.) addressed at promoting its usage as a financing vehicle.

ESMA recently published an Advice on Crowdfunding to European Parliament, Council, and Commission taking into account the need of promotion and clarification, while at the same time preserving investor protection at its highest (http://www.esma.europa.eu/system/files/2014-1560_advice_on_investment-based_crowdfunding.pdf).

The main objective of the report is to assist NCA’s and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are
evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.

Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is pure reception and transmission of orders, in which case a 50,000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission’s programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU–based platforms that could compete with the US ones.
Supply side: institutional investors

### The Green Paper’s analysis of current regulation and tools

#### UCITS V and AIFMD
- The directives are still insufficient to reduce cost and diversify managed funds investment.

#### On pensions and insurance:
- There could be a review of Solvency II (and CRR) delegated acts, to adapt prudential rules for identified sub-classed of lower-risk infrastructure investment.
- The Commission asks which sub-classes should be prioritised for.

#### On professional pensions:
- Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

#### Private equity and venture capital:
- EuVECA and EuSEF Regulations - the clause impeding managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
- Commission asks which measures could be proposed to: increase scale of venture capital funds (both via public and private contributions), improve exit strategies and supply for investors and boost supply of venture capital to start ups.

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as these funds are typically closed-ended and unleveraged; if not - the €100m threshold would apply) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. However, the potential to be caught by AIFMD will deter funds from gaining scale which is ultimately needed to allow a fund to diversify and achieve attractive returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds >€100m compared to 227 in the US\(^1\). The SMSG is aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequences in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive.\(^2\)

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU countries there are still institutional barriers to larger investments by eg pension funds, insurance funds

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\(^1\) Earlybird Europe Venture Capital Report – July 2011
etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so-called prudent person rules.

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?

Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given the lower liquidity of the underlying assets.

Review of the tightening of the national private placement regimes for cross-border marketing of especially below threshold funds that followed as a result of the implementation of the AIFMD. Review of the practice of many national CAs to impose additional charges and/or additional conditions (like a French paying agent) for managers who have already been granted the EU-passport in their home jurisdiction.

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?

EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any future proposals to introduce similar regulation for pension funds must not place conditions that adversely impact the ability to directly or indirectly invest in small caps. The capital and liquidity requirements under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest and most liquid blue-chip equities or even only interest bearing instruments like government bonds due to the lower risk weightings for these than equities in general and deter any existing appetite for smaller companies. An appropriate exemption for direct or indirect investment in small cap securities should be implemented.

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

Yes, the creation of a European standardised personal pension product would facilitate cross-border activity since it would allow providers to offer the same product in different member states. Currently, pension providers have to offer country-specific products in line with national legislation, which increases the costs of engaging in cross-border activity. This market fragmentation limits competition between providers and cost-effective products available to EU citizens.

Importantly, the EU legislative framework for a European personal pension should not aim at harmonising all types of existing personal pensions. Instead, the aim should be to create an EU-wide personal...
A pension product that could be offered to EU citizens, in addition to the products that are currently available at national level.

The creation of an EU legislative framework for a European personal pension would open domestic markets to all EU regulated financial institutions, and facilitate cross-border activity thanks to the granting of an EU passport that would allow providers to sell the same EPP across the EU. This would allow providers to centralize some functions, particularly in the areas of investment management and administration, thereby achieving economies of scale and lower operational costs.

It is also important to mention the benefits to EU consumers with the introduction of a standardised European personal pension. Cross-border selling of such product would increase competition between providers, by diversifying the range of product offering and reducing their cost. The increased cross-border activity of providers should also convince leading providers to ensure the cross-border portability of their European personal pension products, thus facilitating the mobility of EU citizens.

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?

The European Venture Capital Funds Regulation (EVCFR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes holdings in SME markets as 'qualifying portfolio companies'. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest institutions do) nor have necessarily worked in the financial industry.

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?

As mentioned above through not imposing overly restrictive capital requirement, not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class. Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor.

Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company’s development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the “valley of death”...
16) Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

Supply side – retail investors

- Commission asks how to increase participation in UCITS by cross-border retail;
- Share best national best practices in the development of simple and transparent investment products for consumers;
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

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

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

ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better enforce existing investor protection rules.

For all this they need their resources to grow, not to be cut.

Also applicable for Q25

The implementation of the ESAs guidelines through peer reviews and their consistent application across the 28 Member States is the most crucial element in ensuring consistent supervision of the ESAs as well as their contribution to consumer and investor protection.

The importance of a level playing field for financial products services regulated by the three ESAs would require better coordination between all three agencies.

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

General comment

Deleted: Review of UCITS directive to identify ways to attract dedicated UCIT funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the ad-vantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make investments directly in SME issuers. UCITS are much more cross-border than AIFs already because the two major domiciles for UCITS are largely “off-shore”: Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross-border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).
The savings rate of households is already quite high in Europe. Also, contrary to what one often reads, individual investors are not more short term nor more risk averse than other investors:

- 62% of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80% of their total savings are long term if property is taken into account.
- DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least).
- By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8% from 2001 to 2010: way before Solvency II.
- The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.
- The involvement of individual investors in SME markets is about twice as large as it is in blue chips.
- What individual investors do not like it high risk – low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the fists category returned a net real after tx return of 20% since 2000, the latter a negative one of minus 14% over the same period.

As mentioned in our introductory statement, an effective capital markets union will only function if EU citizens as individual investors are also attracted to invest in capital markets. Personal pension savings have an important role to play, by channeling EU citizens’ savings into capital markets. Since Europe needs to foster a greater retirement savings culture to ensure pension adequacy, and given the market fragmentation in product design, investments, marketing and distribution rules, a new cost-effective and simple European Personal Pension product with high consumer protection standards could capture the much needed consumer trust. Given the long-term nature of retirement savings, such product could channel savings into long-term and less liquid assets. The creation of a single market for personal pensions – on which EIOPA is currently working – should therefore be seen as a building block of a Capital Markets Union that puts individual investors at its core. We therefore encourage the Commission to take action on the buildup of a single market for personal pensions once it receives EIOPA’s final advice.

Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disproportionately favours large institutional investors at the expense of early stage companies. We would advise caution in such a statement, since the returns are highly dependent on the period under analysis.

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Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax offsetting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.

Further explanation is needed to explain why the savings rate is considered to be high.

According to the ECB, at end 2013, Euro area households held 42% of their financial wealth in deposits. This would mean 58% of their financial wealth is allocated in other financial assets.

It is our vision that if such a high proportion of wealth allocated to deposits could be partially shifted into capital market instruments, this would unlock more capital to finance European businesses and economic growth.

Since this is a question about retail investors, we propose to shift this data to the answer in Question 12.

To which type of investor is this information concerned?

According to the EFAMA 2014 Fact book, investment fund ownership by euro area households decreased from 46% in 2003 to 26.2% in 2012.

Looking at Euro area households’ financial holdings: shares’ holdings decreased from 21.7% to 20% and investment funds’ holdings decreased from 12.5% to 8.5%, between 2003 and 2013 (ECB data).

Where does this data come from and to which type of investors does it refer (households? Non-financial corporations?, …). Which message does this information intend to convey?

It is not clear which message is being conveyed through these figures. We agree with the Commission’s message in its Green Paper that retail investments through capital markets should be fostered. This is also the message conveyed in the first page of this document.
Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected will they be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders’ voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.

Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.

Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.

One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are eg incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax deductible expenses for a company and then taxed in the hands of the recipient, dividends are subject to double taxation (made out of taxed corporate profits and then taxed again in the hands of investors).

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

A simple, standardized Pan-European personal pension plan is needed to increase consumer confidence, thanks to standardized product rules and robust consumer protection rules (please check Q13).

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?

Yes:
- The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further standardise and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance Mediation and IORP Directives should be amended in order to make their summary documents more standardised, simpler, shorter, in Plain English and more comparable between each other and with other investment products.
- IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.
Supply side – non-EU investment

Attracting non-EU investment:

- The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
- The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

EU needs to continue to ensure “reciprocity”, i.e. not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market internationally.

Given that many regulatory initiatives are newly implemented in Europe, and taking into account that markets have become global, the topic of third-country recognition is important. In general, the same level of requirements for third-country enterprises providing their services in a European Member State should be maintained in order to preserve the desired standards of services in the EU. The potentially lower standards from third countries for the same services should not be introduced via recognition procedures. This is particularly sensitive with regard to foreign competition, affecting the growth potential for EU companies.

Therefore, a fair balance needs to be found to allow non-EU companies to provide their services in Europe.

It is important to ensure that global standards and rules put in place by institutions such as the International Organization of Securities Commissions, the Bank for International Settlements and the Financial Stability Board are carefully considered when drafting regulation in order to avoid regulatory arbitrage that could have negative consequences for growth. Safety standards, risk mitigation measures and data protection rules, for example, should be put in place at the highest level possible. A “race to the bottom” should be avoided, so that individual players cannot exploit weak regulatory regimes. Isolated national regulation should be avoided as well.

On the other hand, it is important that European companies are allowed to enter third country markets to provide services abroad. It should be noted that other countries may have high barriers of access to their markets, which is another reason to consider initiatives to ensure that EU market participants are able to offer their services outside the EU on a level playing field with non-EU providers.

In this regard, reciprocity should be requested and maintained with regard to third-country regimes.

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?
Improving the investment chain

Commission’s analysis regarding the single rule book, enforcement and competition includes:

- The single rulebook is a major step forward to enforce EU regulation consistently but the single rule book’s success depends on consistent implementation and enforcement.
- Supervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
- Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
- Market infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

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

Regulatory reconciliation is a key in the next years.

The Capital Markets Union should ensure that the long-term goal is to reduce the regulatory burden to what is essential. Additionally, loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences.

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?

Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to “crack-down” on national CAs who go further than what has been envisaged under certain Directives?

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?

The overall legal framework for securities varies widely by country. For example, legal barriers make it much more complex to hold securities cross-border, and lead to higher costs for transactions. In addition, they cause difficulties and uncertainty among investors when they exercise their rights abroad.

Given that legal uncertainty of this nature acts as a barrier to financial stability and growth, the European Commission has been examining barriers within securities markets for several years, with the aim of creating a stable and efficiently functioning single market.

Continued harmonisation of rules and standards is essential to eliminate costly barriers and reduce complexity for investors and companies. Initiatives in this area, building on the Single Rulebook as a harmonised regulatory framework, should increase the attractiveness and returns on investment, thereby stimulating economic growth.
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?

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?

Without common applied corporate governance principles/control the Union cannot be done successfully. Thus further harmonisation of national rules and standards are needed in order to eliminate costly barriers and reduce complexity for investors is essential.

The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and size) company statutory reporting info for the last 12 years is available (for purchase) via the web-site www.allabolag.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

Language is another impediment.

Despite significant progress towards the European single market, capital markets are still fragmented with regard to company law, corporate governance rules, creating barriers that hamper the free flow of capital. Those barriers across regions make cross-border investments complex and expensive, and therefore less attractive. The Single Rulebook has not yet been fully achieved.

Continued harmonisation of national rules and standards in order to eliminate costly barriers and reduce complexity for investors is essential.

The exercise of cross-border voting rights and the operational complexity of the voting chain is an obstacle to integrated capital markets arising from company law and corporate governance.

The concept of differential/enhanced voting rights, introduced in some Member States, could impact cross-border investment flows, one of the key objectives of a Capital Markets Union. It would favour majority shareholders, often domestic entities over minority shareholders, generally cross-border large and individual shareholders.

A consistent legal framework for creditor protection and insolvency across the EU would also facilitate cross-border investment.

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

Different national insolvency laws make cross-border services expensive. Reducing the existing inefficiencies will play an important role in unleashing the wider macroeconomic benefits from integrating European securities markets.
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?

- Eliminate the double taxation of cross-border dividends and interests within the EU and end tax discriminations against EU investors domiciled in another Member state than the investment provider.

- Review of EU State Aid risk capital guidelines to allow for effective incentive schemes to be adopted by Member States. The guidelines should recognise the role of expansion capital as genuine risk capital. Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Exemption of certain investment rules imposed on certain investors in the case of investments in SMEs (e.g., minimum ratings, liquidity of securities, etc.). This would need to be balanced with any risk of misallocation of capital.

The Financial Transaction Tax, would increase transaction costs in European financial centres and could therefore impede the goals of the Capital Markets Union. SMEs in particular would face higher capital raising costs as a result of rising transaction costs. Retail investors would also suffer greater financial losses as the tax directly hits retirement provision products. Further, if the financial transaction tax, is introduced in 11 Member States this contradicts the harmonisation intentions within the European Union. However, if introduced, it should not apply to SME transactions. Given that investors in smaller companies usually require a higher rate of return on investment, an additional tax would have a disproportionate increase in the cost of capital for smaller companies and is likely to deter investors from this asset class.

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?

MiFID has posed serious challenges to the bank and broker intermediation chain potentially harming local funding ecosystems

With regard to Regulated Markets and MTFs, the increased transparency included in regulation such as MiFID represents a challenge for SMEs, resulting in a suboptimal time allocation for SMEs’ board and management and ensuing increased costs of accessing public markets. In addition, MiFID has also heightened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain. At the end
of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the Uk in 2014, where it now counts 33 participants.

Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a "work zone" supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is "capital neutral" to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.

It is made up of different phases:

• 1° phase - GET READY: It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities.

• 2° phase - GET FIT: New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support, where appropriate, of a dedicated external advisory team.

• 3° phase – GET VALUE: Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European ELITE community of advisers, investors and stakeholders.

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• The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.

• Transaction costs should be lowered towards the US level

• Actual consolidated tape – free for individual investors after a few minutes – should be now eventually enforced in Europe. A debate on the consolidated tape, as included in the data and reporting section, should be addressed within MiFID II. Article 90.2. MiFID II even includes a review clause for the CTP regime. To avoid double regulation, its strongly recommended to delete the part on consolidated tape.
Dear all,

Just to recap: in our previous report (from October 2012) we had chosen to look at SMEs as those companies having a market capitalization/enterprise value below 500 million. This is what the report states: "The Commission’s definition of an SME (for the purposes of this capital market regime) with a threshold of €100m is inappropriate. The group believes that policy makers should look at adjusting the threshold and suggests that it should be set at €500m”.

I assume – also from a coherence perspective - that our CMU response we look work on the same basis.

Kind regards,

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However, as I have included in my comments, and this is something supported by the EU Parliament’s IPO task force under [redacted], expanding to 500 would be very helpful for running our SME Growth market, so in fact am supportive of this applying to securities.

Yours

Dear [redacted],

Thank you for your detailed comments. I agree with you, we should be always specific to define what we are talking about.

I was considering the private placement of equities or debt issued directly by SMEs or even larger issuers. I was not considering the placement of AIFs who are managed by professionals. In that case 500 or even more buyers of those AIFs are OK with me.

I pity [redacted] in her undertaking to make this paper coherent and understandable. She will enjoy May 1st.....

Kind regards

[redacted]
Dear [Name],

Having read the document again over the week-end I notice that one of the challenges we have when we try to address things is that we do not sufficiently distinguish between the private and public markets and hence, depending on which of the markets we come from, we use the same terms but meaning different contexts. Not only does this apply to SMEs, which in an AIFMD context for example are defined as having no more than 250 employees and either of 50 MEUR in turnover or assets of 43 MEUR. Quite different from the public market SMEs as defined by MiFID as having a market cap of 200 MEUR...and leaving a large grey area of SMEs inbetween for whom eg reporting obligations under the AIFMD may still be quite disproportionate....

This difference in context also goes for the term private placements. In the paper it is under section 5 Developing a European Private Placement scheme mainly used in the context of issuers issuance and placement of debt obligations. But private placements can, amongst other, also refer to fundraisings by fund managers (also AIFMs) of different AIFs. And while fully agreeing that closed ended long-term illiquid funds are ill-suited to direct investment by individual investors they can be very well suited to investment by semi-professional or so called qualified investors. The definitions of which need to be improved, clarified and harmonized and move away from the MiFID definition of what constitutes a professional investor and what hence by default is not. Looking at VC or impact investments for example, having to, as a business angel or entrepreneur to invest at least 100,000 EUR in each early stage or small fund you may not want to do, nor even be able to do financially (if you want risk diversification) – but you may still be fully aware of how the industry works and able to understand the risks and thus contributing not only patient but also smart capital. The AUM/investment size criteria is in itself imperfect – just because somebody suddenly inherits millions or makes millions playing soccer does not automatically make them savvy investors....

Anyway, so my reference to increasing the 150 person limit to 500 come from a private fund placement context and thinking more of the semi-professional/qualified investor perspective, but I am happy to let it go or reduce it, as in most cases, if the 150 limit is indeed per Member State and not, as I first thought, aggregate across Europe, it should, in this context typically be sufficient.

There is one more matter that has come to mind and that is difference in how equity issues and bond issues are subscribed for. For equities the subscription period could run for 2 or more weeks and then one decides allotments. For bonds it is quite often first come first serve and an issue with a 300 page prospectus may be done within 10 minutes and the only chance is to jump right in without reading the prospectus. Should we say anything about this when we generally talk about the different treatments of equity and debt?

Have a good week all!

3
(PS will send a revised mark-up to [redacted] where I will address this need to better distinguish between private and public markets and different types of private placements (as they are all really only exemptions under the PD, AIFMD etc).

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Dear [redacted],
It is a question of definition. For me a private placement is by definition illiquid since there is no secondary market organised for the issue. This is why there is no requirement for prospectus etc... If you have a large distribution of a security which is very liquid, it is not any longer a private placement since it may end in the hands of unsophisticated investors.
Often in Europe it is the opposite: we have issues which are placed privately but "listed" in Luxembourg to permit certain institutions to buy them since they can only buy listed issues.
Amitiés
I think we still agree! I fully agree that private placements not offering full liquidity should be limited to professional or semi-professional investors. I should perhaps have been clearer on that in my commenting. But what about private placements of more liquid assets? Should the 100-150 limit still apply there?

Bon week-end!

Sent from my BlackBerry 10 smartphone.

Dear [Name],

As usual I like very much your suggestions and contributions. It is the case today and I fully agree with yours comments. However this time I disagree with your suggestion to increase the number of investors in private placement up to 500. Private placements who do not offer liquidity should only be subscribed by sophisticated investors. Those investors generally invest in sizeable amounts to make it worthwhile to study the issue. SMEs will never issue amounts requiring so many investors. If it is the case then a public offering becomes more efficient.

I wish you a good week end

Kind regards
Dear [Name]

Sorry for my late delivery of a few additional comments to this by now "bulging" paper! Great to see all the interest and contributions!

I have in these tried to focus on the background of the CMU paper – driving growth, innovation and social inclusion in Europe. As SMEs and an enabling infrastructure for these as well as the rest of the European companies are critical in providing growth, jobs and taxes, ensuring long-term funding options to the two are available must be at the heart of our response as well as ensuring that those, who both through the private as well as public capital markets provide this funding are adequately incentivized to do so as well as protected. Personally I do not think that direct retail funding will be the main source of this funding being sought. It will rather come through the institutions that manage the long-term savings of retail investors and many of these will in turn use intermediaries for their non-public market investing into SMEs (remember that only about 25,000 of Europe’s 20 million SMEs are listed!) as well as infrastructure projects. So I believe we need to focus on this reality in our response and do not get too bogged in with thinking individual retail investors investing directly into SMEs and infrastructure projects and how to best protect them in these cases. We need to build both the private as well as public markets in Europe.

Once again, my hat off to you [Name] for having pulled this paper together in the first place and best of luck now on the final stretch of pulling all the final comments together.

Bon week-end to all!

[Name]
Dear all,

Apologies for another memo to read as background on the CMU, but attached is a fairly technical internal briefing document we have put together on the subject of market structure for SME Growth Markets and as well as less liquid securities. Hopefully you might find it interesting in the overall CMU context.

See you tomorrow.

Yours

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ESMA Securities Markets Stakeholder Group

Contribution to the Green Paper "Building a Capital Markets Union" (CMU)

In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises’ (SME) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium sized companies to have access to funding (through both the private markets as represented by e.g. private equity and venture capital funds as well as through the public markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Preliminary comments

In its initial advice, the SMSG stressed that using capital markets bring many advantages to SMEs including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they would be able to provide (in light of Basel III, possibly the Volcker Rule, the future structure of banking paper etc.) and which in turn would make it increasingly more difficult for them to extend loans to SMEs. The development of the Capital Markets Union, if well designed and executed, may help promote alternative funding sources (both equity and debt), through both the private and public capital markets, to help facilitate the growth which Europe needs.

There is not just one method through which to increase access to funding for SMEs as well as to the infrastructure projects needed by not only these SMEs but companies of all sizes across Europe to help create the enabling environment so critical for efficient sustainable operations and growth.

Fostering a stable, positive environment with access to skilled labour and a diversity of funding sources and instruments, is essential to drive European innovation and growth as well as for addressing the increasing social exclusion seen across Europe.

In its 2012 report, the SMSG concluded that regulatory initiatives often have a combined negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that, in addition to looking into the needs of the SMEs, there is also a need to focus on how to provide to each category of capital providers, ie direct or indirect investors, the right incentives to encourage this broad community to invest not only in equity but also in debt issued by these companies. An efficient, transparent and competitive capital market, be it public or private, providing investors with multiple investment options (both short-term as well as long-term) will be a key component in offering investors the desirable liquidity in their investments.

The Group agrees that, in addition to looking into the needs of the SMEs, there is also a need to focus on how to provide to each category of capital providers, ie direct or indirect investors, the right incentives to encourage this broad community to invest not only in equity but also in debt issued by these companies. An efficient, transparent and competitive capital market, be it public or private, providing investors with multiple investment options (both short-term as well as long-term) will be a key component in offering investors the desirable liquidity in their investments.

In view of the growing institutionalization of people’s savings through pension funds, insurance schemes, mutual funds etc it is important that investments into eg SMEs or infrastructure projects made by these institutions, both directly through the public markets as well as indirectly through intermediaries active
in the private markets are not compromised by aggregated or not sufficiently fit for purpose regulatory initiatives.

This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens also as individual investors. That said, investing directly into SMEs or infrastructure projects generally is, for liquidity and risk diversification reasons, the most likely allocation of retail funds, nor should it be.

In addition, the state of development of capital markets, the structure of the corporate sector, as well as of the institutions, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed within the EU. It is likewise important that actions focus on the financial sector as a whole and on both the private and public capital markets, and help widen and deepen the European capital markets in order to connect different categories of investors with investment opportunities in SMEs and other corporates as well as infrastructure projects across Europe’s 28 Member States.

In order to achieve the objectives of the Capital Markets Union, it is essential to develop initiatives that both cater for the different financing needs of European SMEs as well as critical infrastructure projects while helping to restore investor trust and confidence. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available, directly or indirectly, across Member States. Equally important is to ensure that advisors advising these investors are adequately educated on the products marketed to different investors and the suitability of these for each category.

The Green Paper identifies five priority areas for short term action including the following:
1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;
2. Widening the investor base for SME and improving credit information on SME;
3. Building sustainable securitisation;
4. Boosting long-term investment;
5. Developing European private placement schemes

General comment:
Unfortunately none of these five priorities for the short term involves direct investment by individual investors, except – but probably marginally – ELTIFs. However, the Commission itself rightly points out that “households are the main source of funds to finance investment” (Green Paper on the long term financing of the European economy). Therefore, a successful CMU must involve and attract also individual investors. “It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors … The protection of investors should play a major role in building the CMU” (Steven Maijoor, Chair of ESMA). Improving investor protection and clarifying choices for consumers must also take a prominent place in the CMU initiatives.

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:
1. The Prospectus regime - lowering barriers to accessing capital markets and the proposals regarding:

An effective overall funding environment in Europe must seek to:

- Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.
- Attract a wider set of investors to smaller, growing businesses by reducing the regulatory and fiscal burden on such SME investors.

The SMSG SME believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no 'one-size fits all' solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SME-SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

- More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.
- [Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS)] should be optional for SMEs.
- Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.
- Pre-IPO registration process - prior to the formal offer of securities – would help issuers take advantage of the relatively short term ‘IPO window’. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.
- Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and or key advisers. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained.

- EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMEs. In its current form, the Prospectus – and in particular the "Summary Prospectus" – is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact.
EU initiatives could also encompass looking at increasing the maximum number of investors allowed to be targeted by private placement to 500. Compared to the US, the European private market is lacking in depth and width, but is necessary to complement and eventually “feed” the public markets.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

Alongside investor interests for standardized credit data, a further focus must be put on taking the interests of small companies and small banks such as savings and cooperative banks into account, i.e. the ones having to provide such data. A European solution for company data needs to be designed in such a way that any provision of data takes place on a voluntary and not a mandatory basis, i.e. only when a company is interested in gaining access to larger and international investor groups in the context of funding measures via the capital markets.

**Valuation:** Standardized credit scorings can help to reduce information asymmetries. Though at the same time highly redundant business models based on standardized credit scorings and ratings can lead to significant systemic risks. Therefore investors need also to take on responsibility themselves for adequate risk assessments of their exposure.

3. Securitisation and corporate debt - building debt market financing for SMEs

When exploring the topic of fixed income market financing for SMEs, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an additional definition for the ‘Entreprises de Taille Intermediaire’ which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally. Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies. Further, in the context of the creation of new securities (e.g. private placements), the use of market infrastructures should be promoted, as they increase stability, by using safe, stable and reliable electronic systems, allowing e.g. for notary functions and reconciliation measures (i.e. ensuring integrity of the issue). Services provided by market infrastructures further facilitate an extensive international investors’ reach: not only domestic investors are reached, but also investors on a European and global level may be reached. This reduces the “home-bias” phenomenon.
Alongside banks, companies operating in the real economy also make use of asset-backed securities to gain funding on the capital market. Such securities play an important role for companies, offering advantages – alongside being an attractive way of gaining funding – with regard to corporate indicators, credit line utilization and reporting requirements not available when using other capital market products.

Asset-backed receivables in the form of trade, financing or leasing receivables (the latter generally coming from corporate sales funding subsidiaries) are for the most part sold to so-called “asset-backed commercial paper (ABCP) programs” run by banks (“sponsor banks”).

Features of ABCP funding programs:

- Transaction volumes exceeding ca. €15 million; volumes exceeding €300 million may also be run via co-funding structures, in which two or more ABCP programs jointly finance a single pool.
- Liabilities in different currencies or jurisdictions can be bundled (e.g. when including a corporation’s foreign subsidiaries in a program).
- With regard to trade receivables, it is common practice to provide coverage via trade credit insurance in addition to structural credit enhancements (e.g. discounts on the purchase price, reserves, etc.).
- ABCP programs bundle the individual transactions, refinancing the total volume through the issue of short-term money-market papers, i.e. the ABCPs.
- The “sponsor banks” additionally provide liquidity lines to their ABCP programs. Their purpose to make liquidity available to the program, should it prove difficult to place sufficient ABCPs on the capital market or should transactions turn out to no longer be suitable for capital markets (e.g. in cases where the vendor has become bankrupt or other material events),
- Where an ABCP program’s liquidity lines cover not only the dilution risk but also the credit risk, one speaks of “fully-supported programs”; from a structural point of view these contrast greatly to other forms of asset-backed securities.

Refinancing of SME bank loans through securitisation

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, credit teams for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a show stopper; and the structurally lower visibility of a smaller business a real difficulty.

It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing.
and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as at end 2012 the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIF report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. Pooling and standardisation of loans is needed to ensure transparency and comparability. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.

### Corporate bond markets

There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. There are three notable initiatives in Europe of this nature: the Initial Bond Offering launched by NYSE Euronext in 2012, modelled on equity IPOs; the German Bond M market create by the Stuttgart Stock Exchange in 2010; and the LSE ORB market launched in February 2010.

The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of these mixed results.

There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly though the desired expansion of securitisation to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channelling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access,
transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

4. Boosting Long-term Investments

In its 2012 advice, the SMSG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities as well as to private equity and venture capital funds. If pension funds covered by IORPDS would also have to comply with Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds' ability to invest into equity and other long-term assets, but may over time lead to companies being faced with increased costs for pension benefits, as pension funds find it difficult to generate the necessary long-term returns to match their long-term liabilities. Also the shift from Defined Benefit to Defined Contribution will continue to further impact on the investment strategies of pension institutions.

Given the plethora of investment funds in Europe (33000 versus 8000 in the US which is a more than twice bigger market), it will be difficult to justify the addition of yet further additional categories of long-term funds such as European Long Term Investment Funds (ELTIFs), European Venture Capital (EuVECA) and European Social Entrepreneurship Funds (EuSEF), of a Pan-European personal pension plan (“29th regime”) on the EU market, unless the industry and/or the regulators start streamlining, standardising and simplifying the other long term funds and individual investment product offerings. For example, in France alone, there are already nine long-term AIFs legal categories, most of which are marketed to individual investors, all with special tax provisions. Perhaps the same end-results could be achieved through revisions of the AIFMD and the broadening of "eligibility criteria" for EuVECAs and EUSEFs coupled with lower taxation of capital gains on longer-term investments made by private individuals in general.

5. Developing a European Private Placement scheme

For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldschein) providing approximately €15 billion of debt in 2013.

The German Schuldscheindarlehen Market has a remarkable volume: EUR 68.7 bn with new issuance in 2014 of EUR 11.7 bn shows that Schuldscheindarlehen are a set financing instrument for especially medium sized enterprises (ca. 60% are non-listed companies) which should be considered as reference when thinking about European solutions. Investors have a buy and hold perspective which is also reflected in the average maturity (5.3 yrs).

\[^{1}\text{FCPR, FCPL, FCPE, FIP, OPCI, SICAF, SICAVAS, SCPI, SPSPICAV}^{1}\]

Because in Hungary doesn't have good practice in this subject, I would like to highlight the successful German practice of Private Placements: The Schuldscheindarlehen. As far as I know in particular SMEs of sufficient size (as well as large sized companies) are able to engage in capital markets financing at relatively low transaction costs due to the very flexible level of required documentation (1-15 pages) also no external ratings are necessary. There is a growing demand from international investors as well as European issuers who are increasingly welcoming this lean documentation standard on account of the stable German legal framework. I hope our Germans stakeholder member should confirm the above mentioned.
It’s long track record with very low default rates and the required legal certainty makes the Schuldscheindarlehen an attractive asset class for investors.

These markets provide financing through the use of so called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets. This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be “privately placed” to individual or small groups of institutional investors as in the case for example of reverse enquiry EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the European Private Placement Association (EUPPA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

Any increase in transaction costs, for example through further transparency requirements or an extension of the framework – like the LMA/ICMA standard requires – would make access to this funding instrument more difficult for SMEs.

This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements. Most recently the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:

- Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.
- The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.
As mentioned above, increasing the threshold to 500 investors from the current 100-150 investors could also help build an European private placement market in its full sense and not only limited to debt issuances by corporates, but also covering then private placements by eg below threshold AIFMs to professional and semi-professional investors.
Detailed response to the Commission’s Green Paper

Improving SME access to finance:

The Green Paper’s analysis:

- for SMEs: diversity and scant credit information, preference to relationship based lending (hence banks);
- for start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring
- for mid-caps: access to public markets is costly
- Corporate bond markets lack transparency and standardisation
- Crowdfunding remains focused on national markets

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

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME’s access to finance and investor’s ability to invest.
- “Regulatory reconciliation”: is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e.g. CRD IV/CRR, MiFID II/MiFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.
- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them. Initiatives to promote financial literacy, to develop a capital market culture and to revive investor trust are needed.
- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.

Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital and other early stage fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

Creation of public support specific to these companies (for example, subsidized credit lines).

Commissioning a comparative review of the EU and US high yield debt markets with a specific focus on providing investors access to smaller companies at mutually attractive terms.

Developing a flexible EU “bankruptcy regime” (similar to the Chapter 11 provisions in the US). Further harmonisation/standardisation/removal of barriers.

In addition the following tax incentives could be considered: If start-ups were allowed to offset eg social charges against their tax-loss carry forwards which they typically accumulate during their early years of existence rather than eventually selling them off to a more mature company (who will use them off-set tax on corporate profits), this would help reduce their overall funding needs in the beginning while allowing them to employ staff during critical growth stages of their development.

Revive individual investors’ involvement in equity markets: in 1970 individual investors held directly close to 40 % of EU listed companies, compared to about 13 % today.

Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment products by standardising, simplifying, streamlining and reducing the cost of - packaged investment products.

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?

When SMEs decide to use rating agencies, incentives, also for corporate debt rating, could be considered as follows:

- Reducing information asymmetries between issuers and investors and, as such, the risk premium demanded on loans to SMEs.
- Protecting investors, through the provision of additional information about the additional risks they are incurring with these types of investments.
- Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by recognized External Credit Assessment Institution (ECAI).
- Reducing costs by making the assets accepted as collateral in liquidity-providing operations to banks by the ECB, if the ratings are issued by recognized ECAI.

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

There should be two separate types of ELTIFS, those catering for the needs of institutional investors and those catering for the needs of retail investors. If all ELTIFS are modelled on the needs of retail investors (liquidity; investor protection etc) it risks making them unnecessarily expensive for the institutional investors, who after all are the ones channelling the majority of private savings into the private and
public markets and who are better equipped through their larger portfolios to handle liquidity and risk diversification.

Any successful development of ELTIFs should consider:

- eliminating the plethora of already existing long term fund categories which are nationally incentivised (nine such categories existing in France alone, all with tax incentives).
- Granting the “most favoured nation” clause to ELTIFs for its tax treatment in Member States
- Selling the same ELTIFs to all investors – retail or not, and ban funds of funds which add a layer of fees
- Applying the product disclosure rules of UCITS funds;
- Making listed small cap equity an eligible asset class.
- allowing as well closed-end listed ELTIFs to address the liquidity issue
- Setting a high threshold for minimum investments in ELTIFs: those should be “advised” only to qualified and very financially literate investors.

Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFs can play an important role in capital market funding in the EU, but they need more official support. One of the major barriers ELTIFs will face in trying to develop into a genuine cross-border fund structure, with a UCITS-like passport, is the lack of a level playing field for non-bank providers of credit when compared to bank lenders. Because ELTIFs are intended to invest in illiquid, often private (as opposed to public) assets, ELTIFs may need to operate only nationally if at all, given the various national restrictions on banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFs, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

- the inability of funds to originate loans;
- the need for a banking licence to originate loans;
- bank liabilities preferred on bankruptcy;
- the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
- restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
- different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

EU could undertake a review of the current obstacles to cross-border fundraising which have eg arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.
In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Corporate Private Placement Market Guide published on 11 February 2015), we suggest that a revision of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation (EU) 2015/35) should be considered. Although the final calibrations in the Delegated Act (the "long term guarantees package") has helped remove obstacles to investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investment in private placements, as well as more generally in long-term assets.

Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

Increase the number of investors to 500 as a maximum number for what constitutes a private placement.

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

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, e.g. rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.

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?

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets. It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bonds markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a
standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues from the rest of the sector could come to resemble the more bespoke private placement market, on the other hand.

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<th>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?</th>
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As a preliminary comment, it is important to note that green bonds like any other listed bond come under the scope of existing financial regulation both at the EU and national levels. Green bonds are therefore not being issued in any form of regulatory void. They also benefit from a successful self-regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process represented by the GBP is preferable to a top-down normative approach leading for example to a green bond "label" formally recognized at a regulatory level. This would risk creating unnecessary market segmentation, as well as the perception of potential liabilities for issuers that could dissuade them from entering the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond market as they both experience additional costs compared to mainstream alternatives, and/or in order to maintain or accelerate the development of the market in support of wider public policy objectives related especially to the fight against climate change. The GBP require additional work from green bond issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g. dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green bonds and the underlying environmental projects. These costs are not reflected in the economics of green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal identified above of avoiding a top down normative approach to these securities.

At this stage, it is therefore most likely preferable to allow the green bond market to continue its development based on its current strong momentum and successful self-regulation (within the safeguards provided by mainstream financial regulation). An active dialogue can be maintained on the need for possible future incentives between the Commission and national authorities on the one hand, and industry associations and self-regulatory initiatives on the other.
8) Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

The ESMA SMSG is in favour of the distinct and separate SME market regime under MiFID II and MAD

The SMSG believe that such a regime would have the following benefits:

- recognise the role such markets currently play in the EU funding environment;
- ensure that changes to EU financial services regulation do not adversely impact small caps;
- cater for a secondary market for trading shares of less liquid SMEs;
- allow for further development of regulatory and fiscal EU policies to attract investors to this asset class.

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 one of the emerging financing models that contribute to helping start-ups move up the “funding escalator”, as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refers to open calls to the wider public to raise funds for a specific project. These calls are often published and promoted through the internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds.

- Non financial crowdfunding, includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- Financial crowdfunding, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, Understanding Alternative Finance, Peter Baeck, Liam Collins, Bryan Zhang, November 2014 ) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.
Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects raise funds are themselves also relatively small business. According to the same Nesta report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200,000 pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no previous investment experience. Estimation of activity for the European Union is not easy, and overall figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax reliefs to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, rising awareness, etc.) addressed at promoting its usage as a financing vehicle. ESMA recently published an Advice on Crowdfunding to European Parliament, Council, and Commission taking into account the need of promotion and clarification, while at the same time preserving investor protection at its highest


The main objective of the report is to assist NCA’s and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.

Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is pure reception and transmission of orders, in which case a 50,000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission’s programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU–based platforms that could compete with the US ones.
Supply side: institutional investors

The Green Paper’s analysis of current regulation and tools
UCITS V and AIFMD
- The directives are still insufficient to reduce cost and diversify managed funds investment.

On pensions and insurance:
- There could be a review of Solvency II (and CRR) delegated acts, to adapt prudential rules for identified sub-classed of lower-risk infrastructure investment.
- The Commission asks which sub-classes should be prioritised for.

On professional pensions:
- Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

Private equity and venture capital:
- EuVECA and EuSEF Regulations - the clause impeding managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
- Commission asks which measures could be proposed to: increase scale of venture capital funds (both via public and private contributions, improve exit strategies and supply for investors and boost supply of venture capital to start-ups.

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as these funds are typically closed-ended and unleveraged; if not - the €100 m threshold would apply ) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. Hence the importance of assuring that the national private placement regimes do not work against one another in ensuring cross-border marketing access for such funds wanting to target investors in only one or a handful of Member States.

However, the potential to be caught by AIFMD will deter funds from gaining scale. As the European VC sector grows, develops and matures the likelihood of also venture capital funds becoming larger increases. Today, growth and expansion capital funds, which are in many cases the natural next taker of an early stage company not yet ready to go public, are in many cases unable to benefit from the EuVECA label but too small to carry the full cost and administrative burden of full AIFMD authorization and its ultimate impact on investor returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds >€100m compared to 227 in the US. The SMSG is aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequenc-

1 Earlybird Europe Venture Capital Report – July 2011
es in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive.”

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU countries there are still institutional barriers to larger investments by eg pension funds, insurance funds etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so called prudent person rules.

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?

Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given the lower liquidity of the underlying assets.

There are 33 000 funds in the EU versus 800 in the US. The average size of an EU fund is about € 200 million versus € 1600 million in the US, i.e. 8 times bigger. The annual fees of EU equity funds are 1701 bps (2011: last available info) versus 74 bps in the US (2013).

The number of funds must be drastically reduced, especially AIFs as they are more numerous (about 20 000), smaller and often only distributed on a national basis. For example, Better Finance is proposing to ban AIFs in retail packaged products such as unit-linked insurance contracts and pension plans, in favour of UCITS.

For individual EU investors the problem is compounded by the fact that direct fund holdings account for only 7 % of their financial assets: most economic retail ownership of funds is through wrappers that add yet another layer of costs further reducing the net returns to EU citizens.

Review of the tightening of the national private placement regimes for cross-border marketing of especially below threshold funds that followed as a result of the implementation of the AIFMD. Review of the practice of many national CAs to impose additional charges and/or additional conditions (like a French paying agent) for managers who have already been granted the EU-passport in their home jurisdiction.

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?

EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any future proposals to introduce similar regulation for pension funds must not place conditions that adversely impact the ability to directly or indirectly invest in small caps. The capital and liquidity requirements under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest and most liquid blue-chip equities or even only interest bearing instruments like government bonds due to
the lower risk weightings for these than equities in general and deter any existing appetite for smaller companies. An appropriate exemption for direct or indirect investment in small cap securities should be implemented.

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

Yes

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?

The European Venture Capital Funds Regulation (EVCFR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes holdings in SME markets as ‘qualifying portfolio companies’. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest institutions do) nor have necessarily worked in the financial industry.

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?

As mentioned above through not imposing overly restrictive capital requirement, not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class. Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor. Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company’s development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the “valley of death”...

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

- Commission asks how to increase participation in UCITS by cross-border retail;
- Share best national best practices in the development of simple and transparent investment products for consumers;
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

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

Review of UCITS directive to identify ways to attract dedicated UCIT funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the advantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make investments directly in SME issuers.

UCITS are much more cross-border than AIFs already because the two major domiciles for UCITS are largely “off-shore”: Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross-border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).

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

ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better enforce existing investor protection rules. For all this they need their resources to grow, not to be cut.

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

General comment

The savings rate of household is already quite high in Europe. Also, contrary to what one often reads, individual investors are not more short terms nor more risk averse than other investors:
- 62 % of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80 % of their total savings are long term if property is taken into account.
DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least).

By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8 % from 2001 to 2010: way before Solvency II.

The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.

The involvement of individual investors in SME markets is about twice as large as it is in blue chips.

What individual investors do not like it high risk – low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the first category returned a net real after tx return of 20 % since 2000, the latter a negative one of minus 14 % over the same period.

- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

- Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax offsetting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.

- Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected they will be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders’ voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.

- Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.

- Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.

- One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax deductible expenses for a company and then taxed in the hands of the recipient, divi-
dends are subject to double taxation (made out of taxed corporate profits and then taxed again in the hands of investors).

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

To our knowledge, the longer term the retail investment products are the more complex. This is why a simple, standardized Pan-European personal pension plan is needed.

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

Yes:
- The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further standardise and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance Mediation and IORP Directives should be amended in order to make their summary documents more standardised, simpler, shorter, in Plain English and more comparable between each other and with other investment products.
- IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.
Supply side – non-EU investment

**Attracting non-EU investment:**
- The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
- The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

EU needs to continue to ensure “reciprocity”, i.e. not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market internationally.

Given that many regulatory initiatives are newly implemented in Europe, and taking into account that markets have become global, the topic of third-country recognition is important. In general, the same level of requirements for third-country enterprises providing their services in a European Member State should be maintained in order to preserve the desired standards of services in the EU. The potentially lower standards from third countries for the same services should not be introduced via recognition procedures. This is particularly sensitive with regard to foreign competition, affecting the growth potential for EU companies.

Therefore, a fair balance needs to be found to allow non-EU companies to provide their services in Europe.

It is important to ensure that global standards and rules put in place by institutions such as the International Organization of Securities Commissions, the Bank for International Settlements and the Financial Stability Board are carefully considered when drafting regulation in order to avoid regulatory arbitrage that could have negative consequences for growth. Safety standards, risk mitigation measures and data protection rules, for example, should be put in place at the highest level possible. A “race to the bottom” should be avoided, so that individual players cannot exploit weak regulatory regimes. Isolated national regulation should be avoided as well.

On the other hand, it is important that European companies are allowed to enter third country markets to provide services abroad. It should be noted that other countries may have high barriers of access to their markets, which is another reason to consider initiatives to ensure that EU market participants are able to offer their services outside the EU on a level playing field with non-EU providers.

In this regard, reciprocity should be requested and maintained with regard to third-country regimes.

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?
Improving the investment chain

**Commission’s analysis regarding the single rule book, enforcement and competition includes:**

- The single rulebook is a major step forward to enforce EU regulation consistently but the single rulebook’s success depends on consistent implementation and enforcement.
- Supervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
- Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
- Market infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

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

Regulatory reconciliation is a key in the next years.

The Capital Markets Union should ensure that the long-term goal is to reduce the regulatory burden to what is essential. Additionally, loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences.

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?

Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to “crack-down” on national CAs who go further than what has been envisaged under certain Directives?

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?

The overall legal framework for securities varies widely by country. For example, legal barriers make it much more complex to hold securities cross-border, and lead to higher costs for transactions. In addition, they cause difficulties and uncertainty among investors when they exercise their rights abroad.

Given that legal uncertainty of this nature acts as a barrier to financial stability and growth, the European Commission has been examining barriers within securities markets for several years, with the aim of creating a stable and efficiently functioning single market.

Continued harmonisation of rules and standards is essential to eliminate costly barriers and reduce complexity for investors and companies. Initiatives in this area, building on the Single Rulebook as a harmonised regulatory framework, should increase the attractiveness and returns on investment, thereby stimulating economic growth.
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?

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?

Without common applied corporate governance principles/control the Union cannot be done successfully. Thus further harmonisation of national rules and standards are needed in order to eliminate costly barriers and reduce complexity for investors is essential.

The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and size) company statutory reporting info for the last 12 years is available (for purchase) via the web-site www.allabolag.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

Language is another impediment.

Despite significant progress towards the European single market, capital markets are still fragmented with regard to company law, corporate governance rules, creating barriers that hamper the free flow of capital. Those barriers across regions make cross-border investments complex and expensive, and therefore less attractive. The Single Rulebook has not yet been fully achieved.

Continued harmonisation of national rules and standards in order to eliminate costly barriers and reduce complexity for investors is essential.

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

Different national insolvency laws make cross-border services expensive. Reducing the existing inefficiencies will play an important role in unleashing the wider macroeconomic benefits from integrating European securities markets.

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?

- Eliminate the double taxation of cross-border dividends and interests within the EU and end tax discriminations against EU investors domiciled in another Member state than the investment provider.

- Review of EU State Aid risk capital guidelines to allow for effective incentive schemes to be adopted by Member States. The guidelines should recognise the role of expansion capital as genuine risk capi-
tual. Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Exemption of certain investment rules imposed on certain investors in the case of investments in SMEs (e.g., minimum ratings, liquidity of securities, etc.). This would need to be balanced with any risk of misallocation of capital.

The Financial Transaction Tax, would increase transaction costs in European financial centres and could therefore impede the goals of the Capital Markets Union. SMEs in particular would face higher capital raising costs as a result of rising transaction costs. Retail investors would also suffer greater financial losses as the tax directly hits retirement provision products. Further, if the financial transaction tax, is introduced in 11 Member States this contradicts the harmonisation intentions within the European Union. However, if introduced, it should not apply to SME transactions. Given that investors in smaller companies usually require a higher rate of return on investment, an additional tax would have a disproportionate increase in the cost of capital for smaller companies and is likely to deter investors from this asset class.

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?

MiFID has posed serious challenges to the bank and broker intermediation chain potentially harming local funding ecosystems

With regard to Regulated Markets and MTFs, the increased transparency included in regulation such as MiFID represents a challenge for SMEs, resulting in a suboptimal time allocation for SMES’ board and management and ensuing increased costs of accessing public markets. In addition, MiFID has also heightened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the UK in 2014, where it now counts 33 participants.

Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a “work zone” supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is “capital neutral” to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.
It is made up of different phases:

- **1° phase - GET READY:** It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities.

- **2° phase - GET FIT:** New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support, where appropriate, of a dedicated external advisory team.

- **3° phase – GET VALUE:** Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European ELITE community of advisers, investors and stakeholders.

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- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.

- Transaction costs should be lowered towards the US level.

- Actual consolidated tape – free for individual investors after a few minutes – should be now eventually enforced in Europe. A debate on the consolidated tape, as included in the data and reporting section, should be addressed within MiFID II. Article 90.2. MiFID II even includes a review clause for the CTP regime. To avoid double regulation, its strongly recommended to delete the part on consolidated tape.

- Suggest to shorten this part and mention other SME Market Segments as well (e.g. Deutsche Börse Entry Standard http://www.boerse-frankfurt.de/en/basics+overview/market+segments/entry+standard).

- Please avoid wording “consolidated tape” as this has a different meaning in context of MiFID; suggest to ask for retail data provided by investment firms that delivers investment services to retail customers to ensure best execution (and verification).

- Please add for clarification and to avoid double regulation.
ESMA Securities Markets Stakeholder Group

Contribution to the Green Paper “Building a Capital Markets Union” (CMU)

In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises’ (SME) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium sized companies to have access to funding (through private equity and venture capital funds or through capital markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Preliminary comments

In its initial advice, the SMSG stressed that using capital markets bring many advantages to SMEs including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they are able to provide (in light of Basel III, possibly the Volcker Rule, the future structure of banking paper etc.) that would make it increasingly more difficult to extend loans to SMEs. The development of the Capital Markets Union may promote alternative funding sources (both equity and debt), to facilitate growth. There is not just one method through which to increase access to funding for SMEs: Fostering a stable, positive environment and incentivising companies through attractive and divers funding options is essential. In its 2012 report, the SMSG concluded that regulatory initiatives often have a negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that there is a need to focus on how to provide to each category of investors the right incentives to encourage this broad community to invest not only in equity but also in debt issued by smaller companies and how to structure an efficient, transparent and competitive market so that investors can get reliable liquidity in their investments. This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens as individual investors. In addition, the state of development of capital markets, the needs, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed in the EU. It is likewise important that actions focus on the financial sector as a whole and widen and deepen European capital markets, across not only the euro countries, as in the Banking Union, but across all 28 EU Member States, not as a set of silos.

In order to achieve the objectives of the Capital Markets Union, it is essential to develop initiatives to restore investor trust and confidence, in order to revive demand for new sources of funding. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available across Member States.

The Green Paper identifies five priority areas for short term action including the following:
1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;
2. Widening the investor base for SME and improving credit information on SME;
3. Building sustainable securitisation;
4. Boosting long-term investment;
5. Developing European private placement schemes

General comment:
Unfortunately none of these five priorities for the short term involves individual investors, except – but probably marginally – ELTIs.
However, the Commission itself rightly points out that “households are the main source of funds to finance investment” (Green Paper on the long term financing of the European economy). Therefore, a successful CMU must involve and attract individual investors. “It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors ... The protection of investors should play a major role in building the CMU” (Steven Maijoor, Chair of ESMA). Improving investor protection and clarifying choices for consumers must take a prominent place in the CMU initiatives.

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:

1. The Prospectus regime - lowering barriers to accessing capital markets and the proposals regarding:

An effective overall funding environment in Europe must seek to:

- Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.
- Attract a wider set of investors to smaller, growing businesses by reducing the regulatory and fiscal burden on such SME investors

The SMSG SME believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no ‘one-size fits all’ solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SMSG SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

- More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.
- Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS) - should be optional for SMEs.

- Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.
Pre-IPO registration process - prior to the formal offer of securities – would help issuers take advantage of the relatively short term ‘IPO window’. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.

Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and or key adviser. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained.

EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMEs. In its current form, the Prospectus – and in particular the “Summary Prospectus” - is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

Alongside investor interests for standardized credit data, a further focus must be put on taking the interests of small companies and small banks such as savings and cooperative banks into account, i.e. the ones having to provide such data. A European solution for company data needs to be designed in such a way that any provision of data takes place on a voluntary and not a mandatory basis, i.e. only when a company is interested in gaining access to larger and international investor groups in the context of funding measures via the capital markets.

In this respect, the SMSG also points at the importance of an easy-to-consult Central Rating Repository. Most investors are not aware of smaller, niche rating agencies. A Central Rating Repository would make the ratings by smaller niche rating agencies publicly available, and at the same time contribute to the lesser known agencies be better known.

Valuation: Standardized credit scorings can help to reduce information asymmetries. Though at the same time highly redundant business models based on standardized credit scorings and ratings can lead to significant systemic risks. Therefore investors need also to take on responsibility themselves for adequate risk assessments of their exposure.
3. Securitisation and corporate debt – building debt market financing for SMEs

When exploring the topic of fixed income market financing for SMEs, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an additional definition for the 'Entreprises de Taille Intermediaire' which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally. Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies. Further, in the context of the creation of new securities (e.g. private placements), the use of market infrastructures should be promoted, as they increase stability, by using safe, stable and reliable electronic systems, allowing e.g. for notary functions and reconciliation measures (i.e. ensuring integrity of the issue). Services provided by market infrastructures further facilitate an extensive international investors' reach: not only domestic investors are reached, but also investors on a European and global level may be reached. This reduces the “home-bias” phenomenon.

Alongside banks, companies operating in the real economy also make use of asset-backed securities to gain funding on the capital market. Such securities play an important role for companies, offering advantages – alongside being an attractive way of gaining funding – with regard to corporate indicators, credit line utilization and reporting requirements not available when using other capital market products. Asset-backed receivables in the form of trade, financing or leasing receivables (the latter generally coming from corporate sales funding subsidiaries) are for the most part sold to so-called “asset-backed commercial paper (ABCP) programs” run by banks (“sponsor banks”).

Features of ABCP funding programs:

- Transaction volumes exceeding ca. €15 million; volumes exceeding €300 million may also be run via co-funding structures, in which two or more ABCP programs jointly finance a single pool.
- Liabilities in different currencies or jurisdictions can be bundled (e.g. when including a corporation's foreign subsidiaries in a program);
- With regard to trade receivables, it is common practice to provide coverage via trade credit insurance in addition to structural credit enhancements (e.g. discounts on the purchase price, reserves, etc.).
- ABCP programs bundle the individual transactions, refinancing the total volume through the issue of short-term money-market papers, i.e. the ABCPs.
- The “sponsor banks” additionally provide liquidity lines to their ABCP programs. Their purpose to make liquidity available to the program, should it prove difficult to place sufficient ABCPs on the capital market or should transactions turn out to no longer be suitable for capital markets.
Where an ABCP program’s liquidity lines cover not only the dilution risk but also the credit risk, one speaks of “fully-supported programs”; from a structural point of view these contrast greatly to other forms of asset-backed securities.

## Refinancing of SME bank loans through securitisation

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, credit teams for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a showstopper; and the structurally lower visibility of a smaller business a real difficulty. It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as of end 2012 the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIF report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. Pooling and standardisation of loans is needed to ensure transparency and comparability. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.

In addition, transparency about the origination of loans and about the credit granting process of the originating financial institution would be meaningful information with regard to transparency of securitisations.

## Corporate bond markets

The prelude to the financial crisis, in particularly the American subprime/real estate crisis, was characterised by lowering of standards in the origination of credits and flaws in the credit granting process. Hence, the relevance of including information on the origination of loans and the credit process as information for transparent securitisation.
There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. Three notable initiatives in Europe of this nature: the Initial Bond Offering launched by NYSE Euronext in 2012, modelled on equity IPOs; the German Bond M market create by the Stuttgart Stock Exchange in 2010; and the LSE ORB market launched in February 2010.

The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of these mixed results.

There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly through the desired expansion of securitisation to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channelling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

4. Boosting Long-term Investments

In its 2012 advice, the SMSG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities as well as to private equity and venture capital funds. If pension funds covered by IORPDS would also have to comply with Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds’ ability to invest into equity and other long-term assets, but may over time lead to companies being faced with increased costs for pension benefits, as pension funds find it difficult to generate the necessary long-term returns to match their long-term liabilities.

Given the plethora of investment funds in Europe (33000 versus 8000 in the US which is a more than twice bigger market), it will be difficult to justify the addition of yet further additional categories of long term funds such as European Long Term Investment Funds (ELTIFs), European Venture Capital (EuVECA) and European Social Entrepreneurship Funds (EuSEF), and of a Pan-European personal pension plan (“29th regime”) on the EU market, unless the industry and/or the regulators start streamlining, standardising and simplifying the other long term funds and individual investment product offerings. For example,
in France alone, there are already nine long-term AIFs legal categories, most of which are marketed to individual investors, all with special tax provisions.

5. Developing a European Private Placement scheme

For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldschein) providing approximately €15 billion of debt in 2013.

The German Schuldscheindarlehen Market has a remarkable volume: EUR 68.7 bn with new issuance in 2014 of EUR 11.7 bn shows that Schuldscheindarlehen are a set financing instrument for especially medium sized enterprises (ca. 60% are non-listed companies) which should be considered as reference when thinking about European solutions. Investors have a buy and hold perspective which is also reflected in the average maturity (5.3 yrs).

It’s long track record with very low default rates and the required legal certainty makes the Schuldscheindarlehen an attractive asset class for investors.

These markets provide financing through the use of so called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets. This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be “privately placed” to individual or small groups of institutional investors as in the case for example of reverse enquiry EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the European Private Placement Association (EU PPA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

Any increase in transaction costs, for example through further transparency requirements or an extension of the framework – like the LMA/ICMA standard requires -, would make access to this funding instrument more difficult for SMEs.

1 FCPR, FCPL, FCPE, FEP, OPCI, SICAF, SICAVAS, SCPI, SPPICAV

Because in Hungary doesn’t have good practice in this subject, I would like to highlight the successful German practice of Private Placements: The Schuldscheindarlehen. As far as I know in particular SMEs of sufficient size (as well as large sized companies) are able to engage in capital markets financing at relatively low transaction costs due to the very flexible level of required documentation (1-15 pages) also no external ratings are necessary. There is a growing demand from international investors as well as European issuers who are increasingly welcoming this loan documentation standard on account of the stable German legal framework. I hope our Germans stakeholder member should confirm the above mentioned.
This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements. Most recently the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:

- Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.
- The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.
Detailed response to the Commission’s Green Paper

Improving SME access to finance:

The Green Paper’s analysis:

- for SMEs: diversity and scant credit information, preference to relationship based lending (hence banks);
- for start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring
- for mid-caps: access to public markets is costly
- Corporate bond markets lack transparency and standardisation
- Crowdfunding remains focused on national markets

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

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME’s access to finance and investor’s ability to invest.
- “Regulatory reconciliation”: is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e.g. CRD IV/CRR, MiFID II/MiFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.
- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them. Initiatives to promote financial literacy, to develop a capital market culture and to revive investor trust are needed.
- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.

Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital and other early stage fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

Creation of public support specific to these companies (for example, subsidized credit lines).

Commissioning a comparative review of the EU and US high yield debt markets with a specific focus on providing investors access to smaller companies at mutually attractive terms.

Developing a flexible EU “bankruptcy regime” (similar to the Chapter 11 provisions in the US). Further harmonisation/standardisation/removal of barriers.

In addition the following tax incentives could be considered: If start-ups were allowed to off-set eg social charges against their tax-loss carry forwards which they typically accumulate during their early years of existence rather than eventually selling them off to a more mature company (who will use them to off-set tax on corporate profits), this would help reduce their overall funding needs in the beginning while allowing them to employ staff during critical growth stages of their development.

Revive individual investors’ involvement in equity markets: in 1970 individual investors held directly close to 40 % of EU listed companies, compared to about 13 % today.

Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment products by standardising, simplifying, streamlining and reducing the cost of - packaged investment products.

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?

When SMEs decide to use rating agencies, incentives, also for corporate debt rating, could be considered as follows:

- Reducing information asymmetries between issuers and investors and, as such, the risk premium demanded on loans to SMEs.
- Protecting investors, through the provision of additional information about the additional risks they are incurring with these types of investments.
- Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by recognized External Credit Assessment Institution (ECAI).
- Reducing costs by making the assets accepted as collateral in liquidity-providing operations to banks by the ECB, if the ratings are issued by recognized ECAI.

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

There should be two separate types of ELTIFS, those catering for the needs of institutional investors and those catering for the needs of retail investors. If all ELTIFS are modelled on the needs of retail investors (liquidity; investor protection etc) it risks making them unnecessarily expensive for the institutional investors.

Another aspect with regards to External Credit Assessment Institutions (ECAI) is the cost structure. Bearing in mind the lack of personal relationships to SME owners and the low level of standardization in the SME market it is very doubtful that such institutions can run a proper and ongoing risk assessment for SME at adequate costs (looking at transaction sizes). Besides that cross correlations are very difficult to model, especially but not exclusively with regards to SMEs. This is important when looking at the aim of the COM to foster SME loan securitization.
Any successful development of ELTIFs should consider:

- eliminating the plethora of already existing long term fund categories which are nationally incentivised (nine such categories existing in France alone, all with tax incentives);
- granting the “most favoured nation” clause to ELTIFs for its tax treatment in Member States;
- selling the same ELTIFs to all investors – retail or not, and ban funds of funds which add a layer of fees;
- applying the product disclosure rules of UCITS funds;
- making listed small cap equity an eligible asset class.

Allowing as well closed-end listed ELTIFs to address the liquidity issue.

Setting a high threshold for minimum investments in ELTIFs: those should be “advised” only to qualified and very financially literate investors.

Considering accounting treatment at banks or insurance companies investing in ELTIF’s that does not impose mark to market, as long as they are held to maturity.

Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFs can play an important role in capital market funding in the EU, but they need more official support. One of the major barriers ELTIFs will face in trying to develop into a genuine cross-border fund structure, with a UCITS-like passport, is the lack of a level playing field for non-bank providers of credit when compared to bank lenders. Because ELTIFs are intended to invest in illiquid, often private (as opposed to public) assets, ELTIFs may need to operate only nationally if at all, given the various national restrictions on banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFs, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

- the inability of funds to originate loans;
- the need for a banking licence to originate loans;
- bank liabilities preferred on bankruptcy;
- the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
- restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
- different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

EU could undertake a review of the current obstacles to cross-border fundraising which have eg arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.
In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Corporate Private Placement Market Guide published on 11 February 2015), we suggest that a revision of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation (EU) 2015/35) should be considered. Although the final calibrations in the Delegated Act (the "long term guarantees package") has helped remove obstacles to investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investment in private placements, as well as more generally in long-term assets.

Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

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

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, e.g. rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.

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?

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be im-proved and be set at par with those of equity markets. It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bonds markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap
borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues from the rest of the sector could come to resemble the more bespoke private placement market, on the other hand.

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?

As a preliminary comment, it is important to note that green bonds like any other listed bond come under the scope of existing financial regulation both at the EU and national levels. Green bonds are therefore not being issued in any form of regulatory void. They also benefit from a successful self-regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process represented by the GBP is preferable to a top-down normative approach leading for example to a green bond "label" formally recognized at a regulatory level. This would risk creating unnecessary market segmentation, as well as the perception of potential liabilities for issuers that could dissuade them from entering the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond market as they both experience additional costs compared to mainstream alternatives, and/or in order to maintain or accelerate the development of the market in support of wider public policy objectives related especially to the fight against climate change. The GBP require additional work from green bond issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g. dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green bonds and the underlying environmental projects. These costs are not reflected in the economics of green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal identified above of avoiding a top down normative approach to these securities.

At this stage, it is therefore most likely preferable to allow the green bond market to continue its development based on its current strong momentum and successful self-regulation (within the safeguards provided by mainstream financial regulation). An active dialogue can be maintained on the need for possible future incentives between the Commission and national authorities on the one hand, and industry associations and self-regulatory initiatives on the other.

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

The ESMA SMSG is in favour of the distinct and separate SME market regime under MiFID II and MAD
The SME Specialist Group believe that such a regime would have the following benefits:

- recognise the role such markets currently play in the EU funding environment;
- ensure that changes to EU financial services regulation do not adversely impact small caps;
- cater for a secondary market for trading shares of less liquid SMEs;
- allow for further development of regulatory and fiscal EU policies to attract investors to this asset class.

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 one of the emerging financing models that contribute to helping start-ups move up the “funding escalator”, as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refer to open calls to the wider public to raise funds for a specific project. These calls are often published and promoted through the internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds.

- Non financial crowdfunding, includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- Financial crowdfunding, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, Understanding Alternative Finance, Peter Baeck, Liam Collins, Bryan Zhang, November 2014) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.

Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects raise funds are themselves also relatively small business. According to the same report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200,000.
pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no previous investment experience. Estimation of activity for the European Union is not easy, and overall figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax reliefs to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, rising awareness, etc.) addressed at promoting its usage as a financing vehicle.

ESMA recently published an Advice on Crowdfunding to European Parliament, Council, and Commission taking into account the need of promotion and clarification, while at the same time preserving investor protection at its highest.

The main objective of the report is to assist NCA’s and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.

Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is pure reception and transmission of orders, in which case a 50,000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission’s programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU–based platforms that could compete with the US ones.
Supply side: institutional investors

The Green Paper’s analysis of current regulation and tools

UCITS V and AIFMD
- The directives are still insufficient to reduce cost and diversify managed funds investment.

On pensions and insurance:
- There could be a review of Solvency II (and CRR) delegated acts, to adapt prudential rules for identified sub-classed of lower-risk infrastructure investment.
- The Commission asks which sub-classes should be prioritised for.

On professional pensions:
- Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

Private equity and venture capital:
- EuVECA and EuSEF Regulations - the clause impeding managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
- Commission asks which measures could be proposed to: increase scale of venture capital funds (both via public and private contributions, improve exit strategies and supply for investors and boost supply of venture capital to start ups.

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as these funds are typically closed-ended and unleveraged; if not - the € 100 m threshold would apply ) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. However, the potential to be caught by AIFMD will deter funds from gaining scale which is ultimately needed to allow a fund to diversify and achieve attractive returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds >€100m compared to 227 in the US. The SMSG is aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequences in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive.1

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU countries there are still institutional barriers to larger investments by eg pension funds, insurance funds

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1 Earlybird Europe Venture Capital Report – July 2011
etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so-called prudent person rules.

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?

Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given the lower liquidity of the underlying assets.

There are 33,000 funds in the EU versus 800 in the US. The average size of an EU fund is about €200 million versus €1,600 million in the US, i.e. 8 times bigger. The annual fees of EU equity funds are 1701 bps (2011: last available info) versus 74 bps in the US (2013).

The number of funds must be drastically reduced, especially AIFs as they are more numerous (about 20,000), smaller and often only distributed on a national basis. For example, Better Finance is proposing to ban AIFs in retail packaged products such as unit-linked insurance contracts and pension plans, in favour of UCITS.

For individual EU investors the problem is compounded by the fact that direct fund holdings account for only 7% of their financial assets: most economic retail ownership of funds is through wrappers that add yet another layer of costs further reducing the net returns to EU citizens.

Review of the tightening of the national private placement regimes for cross-border marketing of especially below threshold funds that followed as a result of the implementation of the AIFMD. Review of the practice of many national CAs to impose additional charges and/or additional conditions (like a French paying agent) for managers who have already been granted the EU-passport in their home jurisdiction.

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?

EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any future proposals to introduce similar regulation for pension funds must not place conditions that adversely impact the ability to directly or indirectly invest in small caps. The capital and liquidity requirements under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest and most liquid blue-chip equities or even only interest-bearing instruments like government bonds due to the lower risk weightings for these than equities in general and deter any existing appetite for smaller companies. An appropriate exemption for direct or indirect investment in small cap securities should be implemented.

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

The European Venture Capital Funds Regulation (EVCFR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes holdings in SME markets as ‘qualifying portfolio companies’. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest institutions do) nor have necessarily worked in the financial industry.

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?

As mentioned above through not imposing overly restrictive capital requirement, not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class.

Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor.

Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company’s development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the “valley of death”...

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

- Commission asks how to increase participation in UCITS by cross-border retail;
- Share best national best practices in the development of simple and transparent investment products for consumers;
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

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

Review of UCITS directive to identify ways to attract dedicated UCIT funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the advantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make investments directly in SME issuers.

UCITS are much more cross-border than AIFs already because the two major domiciles for UCITS are largely “off-shore”: Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross-border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).

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

ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better enforce existing investor protection rules. For all this they need their resources to grow, not to be cut.

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

General comment

The savings rate of household is already quite high in Europe. Also, contrary to what one often reads, individual investors are not more short term nor more risk averse than other investors:

- 62% of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80% of their total savings are long term if property is taken into account.
DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least).

By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8% from 2001 to 2010: way before Solvency II.

The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.

The involvement of individual investors in SME markets is about twice as large as it is in blue chips.

What individual investors do not like is high risk – low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the first category returned a net real after tax return of 20% since 2000, the latter a negative one of minus 14% over the same period.

- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

- Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax offsetting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMES, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.

- Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected will they be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders’ voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.

- Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.

- Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.

- One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are eg incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax deductible expenses for a company and then taxed in the hands of the recipient, divi-
dends are subject to double taxation (made out of taxed corporate profits and then taxed again in the hands of investors).

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

To our knowledge, the longer term the retail investment products are the more complex. This is why a simple, standardized Pan-European personal pension plan is needed.

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

Yes:
- The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further standardize and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance Mediation and IORP Directives should be amended in order to make their summary documents more standardized, simpler, shorter, in Plain English and more comparable between each other and with other investment products.
- IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.

What about the UKs Simple Financial Products Initiative?
Supply side – non-EU investment

Attracting non-EU investment:
• The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
• The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

EU needs to continue to ensure “reciprocity”, i.e., not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market internationally.

Given that many regulatory initiatives are newly implemented in Europe, and taking into account that markets have become global, the topic of third-country recognition is important. In general, the same level of requirements for third-country enterprises providing their services in a European Member State should be maintained in order to preserve the desired standards of services in the EU. The potentially lower standards from third countries for the same services should not be introduced via recognition procedures. This is particularly sensitive with regard to foreign competition, affecting the growth potential for EU companies.

Therefore, a fair balance needs to be found to allow non-EU companies to provide their services in Europe.

It is important to ensure that global standards and rules put in place by institutions such as the International Organization of Securities Commissions, the Bank for International Settlements and the Financial Stability Board are carefully considered when drafting regulation in order to avoid regulatory arbitrage that could have negative consequences for growth. Safety standards, risk mitigation measures and data protection rules, for example, should be put in place at the highest level possible. A “race to the bottom” should be avoided, so that individual players cannot exploit weak regulatory regimes. Isolated national regulation should be avoided as well.

On the other hand, it is important that European companies are allowed to enter third country markets to provide services abroad. It should be noted that other countries may have high barriers of access to their markets, which is another reason to consider initiatives to ensure that EU market participants are able to offer their services outside the EU on a level playing field with non-EU providers.

In this regard, reciprocity should be requested and maintained with regard to third-country regimes.

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?
Improving the investment chain

**Commission’s analysis regarding the single rule book, enforcement and competition includes:**
- The single rulebook is a major step forward to enforce EU regulation consistently but the single rulebook’s success depends on consistent implementation and enforcement.
- Supervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
- Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
- Market infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

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

Regulatory reconciliation is a key in the next years.

The Capital Markets Union should ensure that the long-term goal is to reduce the regulatory burden to what is essential. Additionally, loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences.

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?

Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to “crack-down” on national CAs who go further than what has been envisaged under certain Directives?

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?

The overall legal framework for securities varies widely by country. For example, legal barriers make it much more complex to hold securities cross-border, and lead to higher costs for transactions. In addition, they cause difficulties and uncertainty among investors when they exercise their rights abroad.

Given that legal uncertainty of this nature acts as a barrier to financial stability and growth, the European Commission has been examining barriers within securities markets for several years, with the aim of creating a stable and efficiently functioning single market.

Continued harmonisation of rules and standards is essential to eliminate costly barriers and reduce complexity for investors and companies. Initiatives in this area, building on the Single Rulebook as a harmonised regulatory framework, should increase the attractiveness and returns on investment, thereby stimulating economic growth.
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?

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?

Without common applied corporate governance principles/control the Union cannot be done successfully. Thus further harmonisation of national rules and standards are needed in order to eliminate costly barriers and reduce complexity for investors is essential.

The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and size) company statutory reporting info for the last 12 years is available (for purchase) via the web-site www.allabolag.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

Language is another impediment.

Despite significant progress towards the European single market, capital markets are still fragmented with regard to company law, corporate governance rules, creating barriers that hamper the free flow of capital. Those barriers across regions make cross-border investments complex and expensive, and therefore less attractive. The Single Rulebook has not yet been fully achieved.

Continued harmonisation of national rules and standards in order to eliminate costly barriers and reduce complexity for investors is essential.

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

Different national insolvency laws make cross-border services expensive. Reducing the existing inefficiencies will play an important role in unleashing the wider macroeconomic benefits from integrating European securities markets.

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?

- Eliminate the double taxation of cross-border dividends and interests within the EU and end tax discriminations against EU investors domiciled in another Member state than the investment provider.

- Review of EU State Aid risk capital guidelines to allow for effective incentive schemes to be adopted by Member States. The guidelines should recognise the role of expansion capital as genuine risk capi-
Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Exemption of certain investment rules imposed on certain investors in the case of investments in SMEs (e.g., minimum ratings, liquidity of securities, etc.). This would need to be balanced with any risk of misallocation of capital.

The Financial Transaction Tax, would increase transaction costs in European financial centres and could therefore impede the goals of the Capital Markets Union. SMEs in particular would face higher capital raising costs as a result of rising transaction costs. Retail investors would also suffer greater financial losses as the tax directly hits retirement provision products. Further, if the financial transaction tax, is introduced in 11 Member States this contradicts the harmonisation intentions within the European Union. While acknowledging the issue of liquidity in particular for SME’s, other members insist on adding that this is but one element in the wider debate on FTT. However, if introduced, it should not apply to SME transactions. Given that investors in smaller companies usually require a higher rate of return on investment, an additional tax would have a disproportionate increase in the cost of capital for smaller companies and is likely to deter investors from this asset class.

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?

MIFID has posed serious challenges to the bank and broker intermediation chain potentially harming local funding ecosystems

With regard to Regulated Markets and MTFs, the increased transparency included in regulation such as MiFID represents a challenge for SMEs, resulting in a suboptimal time allocation for SMEs’ board and management and ensuing increased costs of accessing public markets. In addition, MiFID has also heightened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the UK in 2014, where it now counts 33 participants.

Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a “work zone” supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is
“capital neutral” to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.

It is made up of different phases:

• 1° phase - GET READY: It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities.

• 2° phase - GET FIT: New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support, where appropriate, of a dedicated external advisory team.

• 3° phase – GET VALUE: Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European ELITE community of advisers, investors and stakeholders.

Elite was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the Uk in 2014, where it now counts 33 participants. In December 2014 Borsa Italiana and the London Stock Exchange Group have presented the imminent launch of a Europe-wide Elite program at the European Parliament; it will be a European platform deeply rooted in each domestic market, through partnerships with local institutions enabling companies to access support and advice throughout Europe.

The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.

Transaction costs should be lowered towards the US level

Actual consolidated tape – free for individual investors after a few minutes – should be now eventually enforced in Europe. A debate on the consolidated tape, as included in the data and reporting section, should be addressed within MiFID II. Article 90.2. MiFID II even includes a review clause for the CTP regime. To avoid double regulation, its strongly recommended to delete the part on consolidated tape.
Dear [Redacted]

Many thanks for your message. I am very grateful that you have accepted our invitation to address our RPC Committee on 12 June.

My colleague [Redacted] and I will be in touch with your office to finalise the organisation of your participation.

With best regards

Dear [Redacted]

It was good to see you at the first (new) SMG meeting and I look forward to many more fruitful exchanges of views.

Thank you very much for inviting me to address the ICMA Regulatory Policy Committee meeting on 12 June in Paris. I am happy to confirm my availability for a presentation of ESMA’s latest work and a discussion between 11h00 and 12h00.

For further details, please contact my Assistant, [Redacted].

Kind regards
Dear [Name],

I am honoured to have recently become a member of ESMA’s Securities and Markets Stakeholder Group and look forward to contributing to the SMSG’s opinions and advice to ESMA on a personal capacity during the current critical phase of the upgrading of financial regulation and supervision.

As [Name], I am also keen to continue to ensure an effective and fruitful dialogue between ESMA and ICMA, the mutual benefit of which should be greater than ever given the extent of the work ESMA is currently called to perform in those areas of the capital market which fall under ICMA’s purview.

In this context, notwithstanding that we recognise that you already have a very busy agenda, on behalf of the members of ICMA’s Regulatory Policy Committee (RPC) and [Name], we would be most pleased if you were able to accept our invitation to address the next ICMA RPC meeting, which is being arranged to take place on 12 June. If you are available to accept this invitation we will arrange for the meeting to be held in Paris and would anticipate starting at 11 am (CET). Should this not be possible for you we would be interested to explore alternative dates or times.

As you may know, the ICMA RPC comprises a mix of the government affairs, regulatory and compliance heads in member firms, together with the chairs of various ICMA market practices committees; and oversees all ICMA’s regulatory policy and market practices work. Particularly in the context of ESMA’s work on MiFIR/MiFID, but also other ongoing regulatory files, they would be very interested to hear an update (say 20 - 30 minutes) on ESMA’s latest work. There would then be the opportunity to conduct a mutually beneficial exchange of views in an open discussion with the ICMA RPC, such that we would anticipate the full session lasting for one hour.


I very much hope that this invitation will receive your favourable consideration.

Best regards to you as well as to [Name] and your colleagues.
Dear [Name],

I thank PHC for this useful and timely update; I would also take the opportunity to propose an important topic for us (or our successor group) to work on: it regards unilateral changes to contracts in the field of asset management, pension funds, insurance contracts etc. In Italy, but perhaps not here only, this right has often been exercised by intermediaries with a brazen face, profiting from:

a) the difficulty for the client to assess the impact of these changes in the first place, and
b) the shenanigans of opting out of the contract.

Should you agree, this matter might be further examined in our forthcoming meetings.

Regards and have a good holiday time, ciao

[Name]

Il giorno 01/ago/2014, alle ore 12:30, [Name] ha scritto:

Dear all,

I hope that I am not disturbing your vacation but I wanted to make a follow up on an important development which is in direct link with our draft advice on the CP of ESMA on MiFID II/MiFIR. As rapporteur on the advice, I am pleased to report that yesterday the Joint Committee of the ESAs issued a statement reminding financial institutions of their responsibilities when placing their own financial products with consumers.

A probe by the ESAs (See joint doc, Point 17, p. 4) revealed cases where “existing depositors have been proactively approached by credit institutions and given the impression that a recommended product is as safe as a deposit or is protected by a deposit guarantee scheme, neither of which has been true”. In other cases, “investors have received no, insufficient or misleading information about product characteristics.”

The ESAs should be congratulated for such step. As you know, the SMSG has been asking for the issue of self placement to be considered by ESMA in 2012 and 2013 and again also in our current advice on the CP on MiFID II/MiFIR. I want to mention here that we enjoyed at the time the full support of [Name]. In our advice, the issue of self placement by financial
institutions has been specifically targeted (3 pages of our advice) and we request strong supervisory measures in the short term and possible regulatory action through a Guideline in the medium term. Here is the executive summary part of our advice on self placement:

On the issue of underwriting and placing, conflicts of interest and provision of information to clients, the SMSG notes with great satisfaction that the issue of self-placement, which it raised with ESMA in 2012 and 2013 with a view to the case of the Participaciones preferentes in Spain, is being singled out in the Consultation Paper. The SMSG advises an even stronger wording of the Technical advice and also that ESMA use the approach developed in Spain by the CNMV as a model and also consider developing a specific Guideline on this issue. In the meantime, the SMSG supports and invites ESMA to exercise strongly its powers in terms of supervisory convergence, especially in relation with the Asset Quality Review (AQR) of the EBA and the stress test of the ECB that will be completed in November 2014.

This is exactly what the ESAs are doing. It is the right thing at the right time, since banks are in the process of raising capital and issuing Cocos. The ESAs should be congratulated for their action. I have done so with Bloomberg as they published an article on the Joint statement yesterday, mentioning also the role of the SMSG of ESMA. Unfortunately, I have not received yet a copy of it but I will send it in due time.

In the meantime, I wish you nice (continued) vacation.

Best regards,

Le 29 juil. 2014 à 11:49, [Name] a écrit :

Dear members of the SMSG,
The WG on retail investors has agreed on the attached paper in response to the consultation on the MiFID Reform. The Steering Committee is very impressed and congratulates both the rapporteur and the many members of the WG. Although a draft version of the paper was presented at our plenary meeting in July and even though the WG on retail investors covers many members of the SMSG, our Rules of Procedure calls for a final distribution of the draft to the whole SMSG and a ten day limit to provide comments, which of course is particularly directed at those members who were not part of the WG to enable their comments. See Art 8(3) RoP. Consequently, if you have any changes to the draft paper please respond by email to the whole SMSG before Thursday August 8 eob.
If you do not have any suggested changes, you do not have to respond as silence is regarded as consent.
If there are changes to the paper, the rapporteur of the WG, [Name] will decide whether they are minor changes that can easily be included or constitute a dissent to the views expressed in the paper. It should be noted that a dissent must be supported by at least three members to be included. After this, the paper will be considered adopted and will appear on our part of the ESMA homepage.
The deadline is slightly later than the consultation deadline, however, as the draft has been debated by the very large WG on retail investors and is of a high quality,
we expect that ESMA may take the draft into account while awaiting our final adoption of the paper.

Kind regards;
Thanks for the heads-up and have a good Easter break yourself!

Best wishes

Hope you both have a nice Easter break and see you soon at the SMSG.

Yours

Dear [Name], thanks for that heads up. Regards,

Dear [Name]
I trust all is well. I just wanted to give you the heads up that a number of firms (ICAP, LCH, LSEG, Nasdaq) are planning to send you a letter tomorrow morning on open access which encourages the direction of travel policy makers have been going and supports your overall stance. It also includes comments on areas where we think the technical standards should not leave wriggle room versus the policy makers intentions. This is really in response to some of the public comments made recently by certain industry players arguing against the overall EU policy position.

We will also be copying in the Econ, Commission, the Presidency, DG Comp.

The idea also is that we would put this up on our websites over the coming day or so, so there is a chance it will pick up press attention.

Hopefully it is constructive towards your overall aims and is certainly meant that way!

Naturally happy to chat about it once you have had the time to digest.

Yours

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Thanks for looking into this. I am still a bit puzzled. EU citizens cannot know who is participating to ESMA hearings. Have a great summer and holidays. Best,

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Dear [Name],

I hope this email finds you well!

You asked me in the margin of the SMSG last week whether it would be possible to get a copy of the list of participants at the MIFID Open Hearing. When checking this internally, it transpires that the question was already raised by [name] a few days ago. We looked into the issue at the time and responded to him. The fact is that the list of participants contains personal data, which we have to process taking into account the requirements laid down in Regulation 45/2001 (which means that we cannot disclose this information to any third party without the express consent of those concerned).

Best regards and, if I don’t speak to you before, I wish you a very good summer and a nice holiday!
ESMA Securities Markets Stakeholder Group

Contribution to the Green Paper "Building a Capital Markets Union" (CMU)

In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises’ (SME) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium sized companies to have access to funding (through private equity and venture capital funds or through capital markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Please note that the document is structured into three distinct parts:
- The SMSG’s preliminary comments
- The SMSG’s comments on the Commission’s 5 priorities for short terms action
- The SMSG’s detailed comments on the Green Paper’s questions

Preliminary Comments

In its initial advice, the SMSG stressed that using capital markets bring many advantages to SMEs including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they are able to provide (in light of Basel III, possibly the Volcker Rule, the future structure of banking paper etc.) that would make it increasingly more difficult to extend loans to SMEs. The development of the Capital Markets Union may promote alternative funding sources (both equity and debt), to facilitate growth. There is not just one method through which to increase access to funding for SMEs: Fostering a stable, positive environment and incentivising companies through attractive and divers funding options is essential. In its 2012 report, the SMSG concluded that regulatory initiatives often have a negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that there is a need to focus on how to provide to each category of investors the right incentives to encourage this broad community to invest not only in equity but also in debt issued by smaller companies and how to structure an efficient, transparent and competitive market so that investors can get reliable liquidity in their investments. This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens as individual investors. In addition, the state of development of capital markets, the needs, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed in the EU. It is likewise important that actions focus on the financial sector as a whole and widen and deepen European capital markets, across not only the euro countries, as in the Banking Union, but across all 28 EU Member States, not as a set of silos.
In order to achieve the objectives of the Capital Markets Union, it is essential to develop initiatives to restore investor trust and confidence, in order to revive demand for new sources of funding. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available across Member States.

**THE GREEN PAPER IDENTIFIES FIVE PRIORITY AREAS FOR SHORT TERM ACTION INCLUDING THE FOLLOWING SCHEMES**:  

1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;  
2. Widening the investor base for SME and improving credit information on SME;  
3. Building sustainable securitisation;  
4. Boosting long-term investment;  
5. Developing European private placement

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:

**1. The Prospectus regime - lowering barriers to accessing capital markets**

An effective overall funding environment in Europe must seek to:

- Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.
- Attract a wider set of investors to smaller or growing businesses or innovation through financing of "research and development programs" by reducing the regulatory and fiscal burden especially on such investors that invest in SME investors

The SMSG SME believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no ‘one-size fits all’ solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SMSG SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

- More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.
- Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS) - should be optional for SMEs

Unfortunately none of these five priorities for the short term involves individual investors, except – but probably marginally – ELTIFs. However, the Commission itself rightly points out that “households are the main source of funds to finance investment” (Green Paper on the long term financing of the European economy). Therefore, a successful CMU must involve and attract individual investors. “It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors … The protection of investors should play a major role in building the CMU” (Steven Maijoor, Chair of ESMA). Improving investor protection and clarifying choices for consumers must take a prominent place in the CMU initiatives.

I have serious doubts on that. We are discussing the proposal for an unified market, but that remark goes on just the opposite direction. If not IFRS, it would mean that national reporting standards could be applied. But those standards would not be understood by investors from other member states, so they would not invest in such companies. So instead of broadening the investors’ base it could lower it drastically. IFRS is a very important tool for creating a CMU, which means a single rulebook that is understood by all the participants throughout the whole EU.

Analogue to EU corporate legislation (for instance the very successful Societas Europaea, SE), a legal framework could be proposed in the fields of accounting, insolvency and fiscal legislation underlining freedom of choice and thereby reflecting both proven national legal systems in Europe and individual needs. A further possibility specifically targeting SMEs and financial reporting requirements would be a stripped-down version of the International Financial Reporting Standards (IFRS), for instance with regard to the necessary attachments, comparable to the size classification used in the EU Accounting Directive. This way, possible barriers to accessing the market could be greatly reduced. The effects of such links to the capital market on financial reporting and the publication of financial information (e.g in a prospectus) would need to be sufficiently measured.
• Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.

• Pre-IPO registration process - prior to the formal offer of securities – would help issuers take advantage of the relatively short term 'IPO window'. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.

• Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and or key adviser. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained.

• EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMEs. In its current form, the Prospectus – and in particular the “Summary Prospectus” - is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

Alongside investor interests for standardized credit data, a further focus must be put on taking the interests of small companies and small banks such as savings and cooperative banks into account, i.e. the ones having to provide such data. A European solution for company data needs to be designed in such a way that any provision of data takes place on a voluntary and not a mandatory basis, i.e. only when a company is interested in gaining access to larger and international investor groups in the context of funding measures via the capital markets.

Valuation: Standardized credit scorings can help to reduce information asymmetries. Though at the same time highly redundant business models based on standardized credit scorings and ratings can lead to significant systemic risks. Therefore investors need also to take on responsibility themselves for adequate risk assessments of their exposure.
3. Securitisation and corporate debt - building debt market financing for SMEs

When exploring the topic of fixed income market financing for SMEs, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an additional definition for the "Entreprises de Taille Intermediaire" which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally. Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies. Further, in the context of the creation of new securities (e.g. private placements), the use of market infrastructures should be promoted, as they increase stability, by using safe, stable and reliable electronic systems, allowing e.g. for notary functions and reconciliation measures (i.e. ensuring integrity of the issue). Services provided by market infrastructures further facilitate an extensive international investors' reach: not only domestic investors are reached, but also investors on a European and global level may be reached. This reduces the “home-bias” phenomenon.

Alongside banks, companies operating in the real economy also make use of asset-backed securities to gain funding on the capital market. Such securities play an important role for companies, offering advantages – alongside being an attractive way of gaining funding – with regard to corporate indicators, credit line utilization and reporting requirements not available when using other capital market products.

Asset-backed receivables in the form of trade, financing or leasing receivables (the latter generally coming from corporate sales funding subsidiaries) are for the most part sold to so-called “asset-backed commercial paper (ABCP) programs” run by banks (“sponsor banks”).

Features of ABCP funding programs:

- Transaction volumes exceeding ca. €15 million; volumes exceeding €300 million may also be run via co-funding structures, in which two or more ABCP programs jointly finance a single pool.
- Liabilities in different currencies or jurisdictions can be bundled (e.g. when including a corporation's foreign subsidiaries in a program).
- With regard to trade receivables, it is common practice to provide coverage via trade credit insurance in addition to structural credit enhancements (e.g. discounts on the purchase price, reserves, etc.).
- ABCP programs bundle the individual transactions, refinancing the total volume through the issue of short-term money-market papers, i.e. the ABCPs.
- The “sponsor banks” additionally provide liquidity lines to their ABCP programs. Their purpose to make liquidity available to the program, should it prove difficult to place sufficient ABCPs on the capital market or should transactions turn out to no longer be suitable for capital markets (e.g. in cases where the vendor has become bankrupt or other material events),
- Where an ABCP program’s liquidity lines cover not only the dilution risk but also the credit risk, one
speaks of “fully-supported programs”; from a structural point of view these contrast greatly to other forms of asset-backed securities.

There is another aspect that should be taken into account: small companies (and new initiatives) are more likely to be financed through tranched securitised instruments, whereas medium size companies are in a better position to directly access capital markets. Consequently, to ensure participation of retail investors in the growth of capital markets, the data that must be provided by the issuers must be equally simple and transparent for investors.

**Refinancing of SME bank loans through securitisation**

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, credit teams for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a show stopper; and the structurally lower visibility of a smaller business a real difficulty.

It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond – bearing however the limits of their embedded derivatives) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as of end 2012 the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIF report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. Pooling and standardisation of loans is needed to ensure transparency and comparability. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.
Corporate bond markets

There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. There are three notable initiatives in Europe of this nature: the Initial Bond Offering launched by NYSE Euronext in 2012, modelled on equity IPOs; the German Bond M market create by the Stuttgart Stock Exchange in 2010; and the LSE ORB market launched in February 2010.

The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of these mixed results.

There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly through the desired expansion of securitisation to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channelling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

4. Boosting Long-term Investments

In its 2012 advice, the SMSG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities as well as to private equity and venture capital funds. If pension funds covered by IORPDS would also have to comply with Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds’ ability to invest into equity and other long-term assets, but may over time lead to companies being faced with increased costs for pension benefits, as pension funds find it difficult to generate the necessary long-term returns to match their long-term liabilities.

Given the plethora of investment funds in Europe (33000 versus 8000 in the US which is a more than twice bigger market), it will be difficult to justify the addition of yet further additional categories of long term funds such as European Long Term Investment Funds (ELTIFs), European Venture Capital (EuVECA)

Why are these 3 mentioned?

Why is this specific report mentioned.

There are good examples of well functioning bonds markets where also retail investors can participate.

Only addressing SME bonds

Actually the share of equity in insurers' investments has started to move sharply down already at least 10 years ago. Same thing happened to UK pension funds although they will be subject to neither Directive.
and European Social Entrepreneurship Funds (EuSEF), and of a Pan-European personal pension plan ("29th regime") on the EU market, unless the industry and/or the regulators start streamlining, standardising and simplifying the other long term funds and individual investment product offerings. For example, in France alone, there are already nine long term AIFs legal categories, most of which are marketed to individual investors, all with special tax provisions1.

5. Developing a European Private Placement scheme

For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldhein) providing approximately €15 billion of debt in 2013. The German Schuldhein Market has a remarkable volume: EUR 68.7 bn with new issuance in 2014 of EUR 13.7 bn shows that Schuldhein are a set financing instrument for especially medium sized enterprises (ca. 60% are non-listed companies) which should be considered as reference when thinking about European solutions. Investors have a buy and hold perspective which is also reflected in the average maturity (5.3 yrs).

It’s long track record with very low default rates and the required legal certainty makes the Schuldhein an attractive asset class for investors.

These markets provide financing through the use of so called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets. This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be "privately placed" to individual or small groups of institutional investors as in the case for example of reverse enquiry EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the European Private Placement Association (EU PPA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

Any increase in transaction costs, for example through further transparency requirements or an extension of the framework – like the LMA/ICMA standard requires -, would make access to this funding instrument more difficult for SMEs.

1 FCPR, FCPI, FCPE, FEP, OPCI, SICAF, SICAVAS, SCPI, SPPICAV
This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements. Most recently the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:

- Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.
- The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.
Detailed response to the Commission’s Green Paper

Improving SME access to finance:

The Green Paper’s analysis:

- for SMEs: diversity and scant credit information, preference to relationship based lending (hence banks);
- for start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring
- for mid-caps: access to public markets is costly
- Corporate bond markets lack transparency and standardisation
- Crowdfunding remains focused on national markets

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

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME’s access to finance and investor’s ability to invest.
- “Regulatory reconciliation”: is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e.g. CRD IV/CRR, MiFID II/MiFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.
- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them. Initiatives to promote financial literacy, to develop a capital market culture and to revive investor trust are needed.
- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.
- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to

early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital and other early stage fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

- Creation of public support specific to these companies (for example, subsidized credit lines).
- Commissioning a comparative review of the EU and US high yield debt markets with a specific focus on providing investors access to smaller companies at mutually attractive terms.
- Developing a flexible EU “bankruptcy regime” (similar to the Chapter 11 provisions in the US). Further harmonisation/standardisation/removal of barriers.
- In addition the following tax incentives could be considered: If start-ups were allowed to off-set eg social charges against their tax-loss carry forwards which they typically accumulate during their early years of existence rather than eventually selling them off to a more mature company (who will use them to off-set tax on corporate profits), this would help reduce their overall funding needs in the beginning while allowing them to employ staff during critical growth stages of their development.
- Revive individual investors’ involvement in equity markets: in 1970 individual investors held directly close to 40% of EU listed companies, compared to about 13% today.
- Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment products by standardising, simplifying, streamlining and reducing the cost of - packaged investment products.

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?

When SMEs decide to userating agencies, incentives, also for corporate debt rating, could be considered as follows:

- Reducing information asymmetries between issuers and investors and, as such, the risk premium demanded on loans to SMEs.
- Protecting investors, through the provision of additional information about the additional risks they are incurring with these types of investments.
- Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by recognized External Credit Assessment Institution (ECAI).
- Reducing costs by making the assets accepted as collateral in liquidity-providing operations to banks by the ECB, if the ratings are issued by recognized ECAI.

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

There should be two separate types of ELTIFs, those catering for the needs of institutional investors and those catering for the needs of retail investors. If all ELTIFs are modelled on the needs of retail investors (liquidity; investor protection etc) it risks making them unnecessarily expensive for the institutional investors.

Any successful development of ELTIFs should consider:

- eliminating the plethora of already existing long term fund categories which are nationally incentivised (nine such categories existing in France alone, all with tax incentives).
• Granting the “most favoured nation” clause to ELTIFs for its tax treatment in Member States
• Selling the same ELTIFs to all investors – retail or not, and ban funds of funds which add a layer of fees
• Applying the product disclosure rules of UCITS funds;
• Making listed small cap equity an eligible asset class,
• allowing as well closed-end listed ELTIFs to address the liquidity issue
• Setting a high threshold for minimum investments in ELTIFs: those should be “advised” only to qualified and very financially literate investors.

Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFs have the potential to play an important role in capital market funding in the EU, if the right incentives for investors are there. Moreover, because ELTIFs can play an important role in capital market funding in the EU, but they need more official support. One of the major barriers ELTIFs will face in trying to develop into a genuine cross-border fund structure, with a UCITS-like passport, is the lack of a level playing field for non-bank providers of credit when compared to bank lenders. Because ELTIFs are intended to invest in illiquid, often private (as opposed to public) assets, ELTIFs may need to operate only nationally if at all, given the various national restrictions on banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFs, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

• the inability of funds to originate loans;
• the need for a banking licence to originate loans;
• bank liabilities preferred on bankruptcy;
• the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
• restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
• different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

EU could undertake a review of the current obstacles to cross-border fundraising which have eg arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.

In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Corporate Private Placement Market Guide published on 11 February 2015 ), we suggest that a revision of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation (EU) 2015/35) should be considered. Although the final calibrations in the Delegated Act (the “long term guarantees package”) has helped remove obstacles to

Proposal to replace this part by: At the same time a single set of rules for all types of investors (retail, professional, small, medium or large) will fail to recognise different needs of such a wide range of investors, ELTIFs seek to attract. Therefore, the possibility to adapt the structure on the different needs of the investors’ base of each ELTIF is necessary to increase their market attractiveness and finally their success in financing of the long-term needs for growth of the EU economy.

The discretion of the asset manager to choose whether to open the ELTIF to retail investors or not along with the discretion as to the portfolio composition and the early redemption rights are welcome. Still, additional effort should be made to attract particular categories of investors such as:

- Small pension plans and local associations that have the capacity (or are sometimes even required) to lock up some of their capital for a period and to diversify their portfolio beyond cash and high liquid securities. As those investors are classified as retail investors they will be excluded from a number of ELTIFs open only to professional investors, whereas the request to be treated as professional investors based on the MIFID criteria is not relevant to them as it might generate too high a legal hurdle and important costs for them.
- Insurance companies who again wish to further diversify their portfolios, but investment on long-term illiquid assets such as infrastructure or non-listed SMEs are “punished” as to the important capital requirements they bring.

Moreover additional flexibility when it comes to the lifetime of the ELTIF in order to make it possible to adapt to the changes in the long-term landscape of its investment strategy, would make it feasible for ELTIFs to take advantage of market opportunities to the benefit of their investors.

Apart from the need to deliver a regulatory framework of ELTIFs able to meet their investors’ needs, it should be stressed that their market potential will be linked to a great extent to the general regulatory environment. Ensuring that substantial incentives are in place includes also the provision of tax incentives and the removal of any fiscal or administrative barriers. Moreover, investors need and seek stable and predictable regulatory environments. This prerequisite becomes even more relevant in the case of illiquid investments, in which the link to a particular jurisdiction is of longer duration.

Finally, education on financial principles and tools for retail investors will help them understand the risks associated with the financing of a long-term project and the economic and social benefits.Proposal to delete this part
investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investment in private placements, as well as more generally in long-term assets.

Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

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

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, eg rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.

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?

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets. It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bonds markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues from the rest of the sector could come to resemble the more bespoke private placement market, on the other hand. Consequently, it might be advisable to start with the standardisation of loans before developing standards on securitisation. Securitisation of SME would be better handled if loans are more
accessible to investors, especially institutional investors. The second step (or alternative approach to complete standardisation) should be to encourage standardisation of the criteria to monitor rather than the values to have access to capital markets.

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

As a preliminary comment, it is important to note that green bonds like any other listed bond come under the scope of existing financial regulation both at the EU and national levels. Green bonds are therefore not being issued in any form of regulatory void. They also benefit from a successful self-regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process represented by the GBP is preferable to a top-down normative approach leading for example to a green bond “label” formally recognized at a regulatory level. This would risk creating unnecessary market segmentation, as well as the perception of potential liabilities for issuers that could dissuade them from entering the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond market as they both experience additional costs compared to mainstream alternatives, and/or in order to maintain or accelerate the development of the market in support of wider public policy objectives related especially to the fight against climate change. The GBP require additional work from green bond issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g. dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green bonds and the underlying environmental projects. These costs are not reflected in the economics of green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal identified above of avoiding a top down normative approach to these securities.

At this stage, it is therefore most likely preferable to allow the green bond market to continue its development based on its current strong momentum and successful self-regulation (within the safeguards provided by mainstream financial regulation). An active dialogue can be maintained on the need for possible future incentives between the Commission and national authorities on the one hand, and industry associations and self-regulatory initiatives on the other.

It is not necessary for the EU to take any legislative action for the development of Environment, Social and Governance ‘ESG’ investment. Numerous recent pieces of legislation introduce ESG disclosure requirements, such as country-by-country reporting, Revision of the Shareholders’ Rights Directive, efforts on conflict minerals, transparency requirements in the UCITS KIID and PRIIPs KID. The impact of these pieces of legislation now needs to be reviewed. However, the European Commission could play a role in
the promotion of ESG. Finally, given the evolving nature of the industry, standardisation of processes should not be discussed at this point of time as market driven initiatives need to be given the space to grow.

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

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 one of the emerging financing models that contribute to helping start-ups move up the “funding escalator”, as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refers to open calls to the wider public to raise funds for a specific project. These calls are often published and promoted through the internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds

- Non financial crowdfunding, includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- Financial crowdfunding, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, Understanding Alternative Finance, Peter Baeck, Liam Collins, Bryan Zhang, November 2014 ) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.

Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects
raise funds are themselves also relatively small business. According to the same Nesta report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200,000 pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no previous investment experience. Estimation of activity for the European Union is not easy, and overall figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax reliefs to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, rising awareness, etc.) addressed at promoting its usage as a financing vehicle. ESMA recently published an Advice on Crowdfunding to European Parliament, Council, and Commission taking into account the need of promotion and clarification, while at the same time preserving investor protection at its highest.

The main objective of the report is to assist NCA’s and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.

Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is pure reception and transmission of orders, in which case a 50,000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission’s programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU–based platforms that could compete with the US ones.

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?

- The ESMA SMSG insists on the need to avoid regulatory barriers to fluid markets such as FTT.
- Regulatory convergence is also very important.
- As developed in our reply to the Question 9, we believe that this should be harmonised in the EU-US trade relationships.
Supply side: institutional investors

The Green Paper’s analysis of current regulation and tools
UCITS V and AIFMD
• The directives are still insufficient to reduce cost and diversify managed funds investment.

On pensions and insurance:
• There could be a review of Solvency II (and CRR) delegated acts, to adapt prudential rules for identified sub-classed of lower-risk infrastructure investment.
• The Commission asks which sub-classes should be prioritised for.

On professional pensions:
• Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

Private equity and venture capital:
• EuVECA and EuSEF Regulations - the clause impeding managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
• Commission asks which measures could be proposed to: increase scale of venture capital funds (both via public and private contributions, improve exit strategies and supply for investors and boost supply of venture capital to start ups.

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as these funds are typically closed-ended and unleveraged; if not - the € 100 m threshold would apply ) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. However, the potential to be caught by AIFMD will deter funds from gaining scale which is ultimately needed to allow a fund to diversify and achieve attractive returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds >€100m compared to 227 in the US. The SMSG is aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequences in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive.7

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU

1 Earlybird Europe Venture Capital Report – July 2011

[7] It is not clear why AIFMD would “deter” funds from gaining scale? Is it to avoid investor protection rules (although those are lighter for AIFs than they are for UCITs)? Please clarify.

[8] What is the substance behind this statement? One of the reasons the US VC funds investment market grew back in the 1990s was the opening up of US pension funds, ERISA, to invest in VC funds.
countries there are still institutional barriers to larger investments by eg pension funds, insurance funds etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so called prudent person rules.

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?

• Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given the lower liquidity of the underlying assets.

• There are 33 000 funds in the EU versus 800 in the US. The average size of an EU fund is about € 200 million versus € 1600 million in the US, i.e; 8 times bigger. The annual fees of EU equity funds are 1701 bps (2011: last available info) versus 74 bps in the US (2013)

• The number of funds must be drastically reduced, especially AIFs as they are more numerous (about 20 000), smaller and often only distributed on a national basis. For example, Better Finance is proposing to ban AIFs in retail packaged products such as unit-linked insurance contracts and pension plans, in favour of UCITS.

• For individual EU investors the problem is compounded by the fact that direct fund holdings account for only 7 % of their financial assets: most economic retail ownership of funds is through wrappers that add yet another layer of costs further reducing the net returns to EU citizens.

• Review of the tightening of the national private placement regimes for cross-border marketing of especially below threshold funds that followed as a result of the implementation of the AIFMD. Review of the practice of many national CAs to impose additional charges and/or additional conditions (like a French paying agent) for managers who have already been granted the EU passport in their home jurisdiction.

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?

• EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any future proposals to introduce similar regulation for pension funds must not place conditions that adversely impact the ability to directly or indirectly invest in small caps.

• The capital and liquidity requirements under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest and most liquid blue-chip equities or even only interest bearing instruments like government bonds due to the lower risk weightings for these than equities in general and deter any existing appetite for smaller companies.

• An appropriate exemption for direct or indirect investment in small cap securities should be implemented.
13) Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

Yes

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?

The European Venture Capital Funds Regulation (EVCFR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes holdings in SME markets as ‘qualifying portfolio companies’. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest institutions do) nor have necessarily worked in the financial industry.

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?

- As mentioned above through not imposing overly restrictive capital requirement, not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class.
- Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor.
- Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company’s development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the “valley of death”...

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

- Commission asks how to increase participation in UCITS by cross-border retail;
- Share best national best practices in the development of simple and transparent investment products for consumers;
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

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

- Review of UCITS directive to identify ways to attract dedicated UCIT funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the advantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make investments directly in SME issuers.

- UCITs are much more cross-border than AIFs already because the two major domiciles for UCITs are largely "off-shore": Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross-border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).

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

- ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in te areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better enforce existing investor protection rules.
- For all this they need their resources to grow, not to be cut. Each ESA should be given the necessary resources to build a Single Rulebook for the sector it supervises.
- A level playing field for financial products services regulated by the three ESAs is essential for ensuring consumer and investor protection.

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

General comment

The savings rate of household is already quite high in Europe. Also, contrary to what one often reads, individual investors are not more short terms nor more risk averse than other investors.
• 62% of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80% of their total savings are long term if property is taken into account.
• DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least)
• By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8% from 2001 to 2010: way before Solvency II.
• The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.
• The involvement of individual investors in SME markets is about twice as large as it is in blue chips.
• What individual investors do not like is high risk–low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the fists category returned a net real after tx return of 20% since 2000, the latter a negative one of minus 14% over the same period.

- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

- Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax offsetting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.

- Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected will they be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders’ voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.

- Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.

- Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.
• One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are eg incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax deductible expenses for a company and then taxed in the hands of the recipient, dividends are subject to double taxation (made out of taxed corporate profits and then taxed again in the hands of investors).

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

To our knowledge, the longer term the retail investment products are the more complex. This is why a simple, standardized Pan-European personal pension plan is needed.

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

• The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further standardise and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance Mediation and IORP Directives should be amended in order to make their summary documents more standardised, simpler, shorter, in Plain English and more comparable between each other and with other investment products.
• IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
• The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.
Supply side – non-EU investment

Attracting non-EU investment:

- The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
- The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

EU needs to continue to ensure "reciprocity", ie not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market internationally.

- Given that many regulatory initiatives are newly implemented in Europe, and taking into account that markets have become global, the topic of third-country recognition is important. In general, the same level of requirements for third-country enterprises providing their services in a European Member State should be maintained in order to preserve the desired standards of services in the EU. The potentially lower standards from third countries for the same services should not be introduced via recognition procedures. This is particularly sensitive with regard to foreign competition, affecting the growth potential for EU companies.

- Therefore, a fair balance needs to be found to allow non-EU companies to provide their services in Europe.

- It is important to ensure that global standards and rules put in place by institutions such as the International Organization of Securities Commissions, the Bank for International Settlements and the Financial Stability Board are carefully considered when drafting regulation in order to avoid regulatory arbitrage that could have negative consequences for growth. Safety standards, risk mitigation measures and data protection rules, for example, should be put in place at the highest level possible. A “race to the bottom” should be avoided, so that individual players cannot exploit weak regulatory regimes. Isolated national regulation should be avoided as well.

- On the other hand, it is important that European companies are allowed to enter third country markets to provide services abroad. It should be noted that other countries may have high barriers of access to their markets, which is another reason to consider initiatives to ensure that EU market participants are able to offer their services outside the EU on a level playing field with non-EU providers.

- In this regard, reciprocity should be requested and maintained with regard to third-country regimes.

The Green Paper focuses solely on the access of EU firms to international markets. The CMU should also take into account the access to the Internal Market by international investors from the EU’s key partner countries. In this regard, the following proposals should be taken into account:
• The EU Commission should take account of the impact of cross-border capital flows in its Impact Assessments when it is developing new proposals. To do this effectively, the views of non-EU partners should be sought in formal dialogues. Through these dialogues, non-EU partner country authorities should be allowed to play an active and constructive role in the development of the CMU to help ensure regulatory coherence and avoid closing borders to investors and financial services.

• The Commission should proactively involve third-country regulators in the development of the CMU action plan to ensure CMU is devised in a way that does not erect barriers around the single market.

• To avoid regulatory arbitrage, the Commission should proactively work with partner countries to develop new international standards and implement them effectively and consistently as was the case with the OECD standard on Automatic Exchange of Information in tax matters, but less so with the implementation of Basel III, which was not wholly consistent.

• The EU should aim to work with IOSCO to develop standards that can internationalise the measures in the capital markets union, in an effort to replicate the success of the OECD in the tax field, and the BIS in the prudential. If some jurisdictions are not prepared to work to IOSCO standards, this should not prevent the EU from developing them with other jurisdictions.

• One of the objectives of CMU should be the development and putting into practice of an improved regime for assessing equivalence with partner countries. This needs to be both pragmatic and predictable, providing a coherent approach in the equivalence determination. The regime needs to take account of the different regulatory environments and approaches in partner countries, eschewing a one-size-fits-all approach, and instead providing for flexibility on the basis of agreed principles. Where the Commission deviates from ESMA advice, it should explain its reasoning, and make clear in advance the criteria it will use to make equivalence decisions, thus providing the market with a higher degree of predictability.

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?
Improving the investment chain

Commission’s analysis regarding the single rule book, enforcement and competition includes:

- The single rulebook is a major step forward to enforce EU regulation consistently but the single rulebook’s success depends on consistent implementation and enforcement.
- Supervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
- Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
- Market infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

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

Regulatory reconciliation is a key in the next years.

The Capital Markets Union should ensure that the long-term goal is to reduce the regulatory burden to what is essential. Additionally, loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences.

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?

- Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to “crack-down” on national CAs who go further than what has been envisaged under certain Directives?
- In relation to ESMA, consistent supervision can be enforced with the implementation of its guidelines through peer reviews and consistent application across the 28 Member States.
- ESMA should also prioritise the promotion of unified reporting requirements.

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?

- The overall legal framework for securities varies widely by country. For example, legal barriers make it much more complex to hold securities cross-border, and lead to higher costs for transactions. In addition, they cause difficulties and uncertainty among investors when they exercise their rights abroad.
• Given that legal uncertainty of this nature acts as a barrier to financial stability and growth, the European Commission has been examining barriers within securities markets for several years, with the aim of creating a stable and efficiently functioning single market.

• Continued harmonisation of rules and standards is essential to eliminate costly barriers and reduce complexity for investors and companies. Initiatives in this area, building on the Single Rulebook as a harmonised regulatory framework, should increase the attractiveness and returns on investment, thereby stimulating economic growth.

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?

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?

• Without common applied corporate governance principles/control the Union cannot be done successfully. Thus further harmonisation of national rules and standards are needed in order to eliminate costly barriers and reduce complexity for investors is essential.

• The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and size) company statutory reporting info for the last 12 years is available (for purchase) via the web-site www.allabolag.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

• Language is another impediment.

• Despite significant progress towards the European single market, capital markets are still fragmented with regard to company law, corporate governance rules, creating barriers that hamper the free flow of capital. Those barriers across regions make cross-border investments complex and expensive, and therefore less attractive. The Single Rulebook has not yet been fully achieved.

• Continued harmonisation of national rules and standards in order to eliminate costly barriers and reduce complexity for investors is essential.

• The exercise of cross-border voting rights and the operational complexity of the voting chain is an obstacle to integrated capital markets arising from company law and corporate governance.

• In addition, the concept of differential/enhanced voting rights, introduced in some Member States, could impact cross-border investment flows, one of the key objectives of a Capital Markets Union. It would favour majority shareholders, often domestic entities over minority shareholders, generally cross-border large and individual shareholders.

• A consistent legal framework for creditor protection and insolvency across the EU would also facilitate cross-border investment.
29) What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

Different national insolvency laws make cross-border services expensive. Reducing the existing inefficiencies will play an important role in unleashing the wider macroeconomic benefits from integrating European securities markets.

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?

- Eliminate the double taxation of cross-border dividends and interests within the EU and end tax discriminations against EU investors domiciled in another Member state than the investment provider.
- Review of EU State Aid risk capital guidelines to allow for effective incentive schemes to be adopted by Member States. The guidelines should recognise the role of expansion capital as genuine risk capital. Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Exemption of certain investment rules imposed on certain investors in the case of investments in SMEs (e.g., minimum ratings, liquidity of securities, etc.). This would need to be balanced with any risk of misallocation of capital.

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?

MiFID has posed serious challenges to the bank and broker intermediation chain potentially harming local funding ecosystems.
With regard to Regulated Markets and MTFs, the increased transparency included in regulation such as MiFID represents a challenge for SMEs, resulting in a suboptimal time allocation for SMEs’ board and management and ensuing increased costs of accessing public markets. In addition, MiFID has also heightened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

It is therefore useful to learn from experiences – such as the ELITE programme – that tries to address this issue.

The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the UK in 2014, where it now counts 33 participants.

Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a “work zone” supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is “capital neutral” to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.

It is made up of different phases:

- **1° phase - GET READY**: It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities.

- **2° phase - GET FIT**: New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support, where appropriate, of a dedicated external advisory team.

- **3° phase – GET VALUE**: Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European ELITE community of advisers, investors and stakeholders.

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For issuers or for market venues? Which regulation is involved? A standardized and short summary prospectus would certainly improve things on both ends: for SME issuers and for investors.

Suggest to shorten this part and mention other SME Market Segments as well (e.g. Deutsche Börse Entry Standard [http://www.boerse-frankfurt.de/en/basics+overview/market+segments/entry+standard])
- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.

- Transaction costs should be lowered towards the US level. Actual consolidated tape – free for individual investors after a few minutes – should be now eventually enforced in Europe. A debate on the consolidated tape, as included in the data and reporting section, should be addressed within MiFID II. Article 90.2. MiFID II even includes a review clause for the CTP regime. To avoid double regulation, it is strongly recommended to delete the part on consolidated tape.

Please avoid wording “consolidated tape” as this has a different meaning in context of MiFID. Suggest to ask for retail data provided by investment firms that delivers investment services to retail customers to ensure best execution (and verification). Please add clarification and to avoid double regulation.
DRAFT – 25 March 2015

ESMA Securities Markets Stakeholder Group
Contribution to the Green Paper “Building a Capital Markets Union” (CMU)

In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises’ (SME) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium sized companies to have access to funding (through private equity and venture capital funds or through capital markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Preliminary comments

In its initial advice, the SMSG stressed that using capital markets bring many advantages to SMEs, including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they are able to provide (in light of Basel III, possibly the Volcker Rule, the future structure of banking paper etc.) that would make it increasingly more difficult to extend loans to SMEs. The development of the Capital Markets Union may promote alternative funding sources (both equity and debt), to facilitate growth. There is not just one method through which to increase access to funding for SMEs: Fostering a stable, positive environment and incentivising companies through attractive and diverse funding options is essential. In its 2012 report, the SMSG concluded that regulatory initiatives often have a negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that there is a need to focus on how to provide to each category of investors the right incentives to encourage this broad community to invest not only in equity but also in debt issued by smaller companies and how to structure an efficient, transparent and competitive market so that investors can get reliable liquidity in their investments. This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens as individual investors. In addition, the state of development of capital markets, the needs, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed in the EU. It is likewise important that actions focus on the financial sector as a whole and widen and deepen European capital markets, across not only the euro countries, as in the Banking Union, but across all 28 EU Member States, not as a set of silos.

In order to achieve the objectives of the Capital Markets Union, it is essential to develop initiatives to restore investor trust and confidence, in order to revive demand for new sources of funding. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available across Member States.
The Green Paper identifies five priority areas for short term action including the following:

1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;
2. Widening the investor base for SME and improving credit information on SME;
3. Building sustainable securitisation;
4. Boosting long-term investment;
5. Developing European private placement schemes

General comment:
Unfortunately none of these five priorities for the short term involves individual investors, except – but probably marginally – ELTIFs. However, the Commission itself rightly points out that “households are the main source of funds to finance investment” (Green Paper on the long term financing of the European economy). Therefore, a successful CMU must involve and attract individual investors. “It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors … The protection of investors should play a major role in building the CMU” (Steven Maijoor, Chair of ESMA). Improving investor protection and clarifying choices for consumers must take a prominent place in the CMU initiatives.

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:

1. The Prospectus regime - lowering barriers to accessing capital markets and the proposals regarding:

An effective overall funding environment in Europe must seek to:

- Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.
- Attract a wider set of investors to smaller or growing businesses or innovation through financing of “research and development programs” by reducing the regulatory and fiscal burden especially on such investors that invest in SME investors.

The SMSG SME believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no ‘one-size fits all’ solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SMSG SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

- More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.
- Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS) - should be optional for SMEs.
Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.

Pre-IPO registration process - prior to the formal offer of securities – would help issuers take advantage of the relatively short term ‘IPO window’. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.

Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and/or key adviser. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained.

EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMEs. In its current form, the Prospectus – and in particular the “Summary Prospectus” - is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

Alongside investor interests for standardized credit data, a further focus must be put on taking the interests of small companies and small banks such as savings and cooperative banks into account, i.e. the ones having to provide such data. A European solution for company data needs to be designed in such a way that any provision of data takes place on a voluntary and not a mandatory basis, i.e. only when a company is interested in gaining access to larger and international investor groups in the context of funding measures via the capital markets.
Valuation: Standardized credit scorings can help to reduce information asymmetries. Though at the same time highly redundant business models based on standardized credit scorings and ratings can lead to significant systemic risks. Therefore investors need also to take on responsibility themselves for adequate risk assessments of their exposure.

3. Securitisation and corporate debt - building debt market financing for SMEs

When exploring the topic of fixed income market financing for SMES, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an additional definition for the ‘Entreprises de Taille Intermediaire’ which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally. Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies.

Further, in the context of the creation of new securities (e.g. private placements), the use of market infrastructures should be promoted, as they increase stability by using safe, stable and reliable electronic systems, allowing e.g. for notary functions and reconciliation measures (i.e. ensuring integrity of the issue). Services provided by market infrastructures further facilitate an extensive international investors' reach: not only domestic investors are reached, but also investors on a European and global level may be reached. This reduces the "home-bias" phenomenon.

Alongside banks, companies operating in the real economy also make use of asset-backed securities to gain funding on the capital market. Such securities play an important role for companies, offering advantages – alongside being an attractive way of gaining funding – with regard to corporate indicators, credit line utilization and reporting requirements not available when using other capital market products.

Asset-backed receivables in the form of trade, financing or leasing receivables (the latter generally coming from corporate sales funding subsidiaries) are for the most part sold to so-called “asset-backed commercial paper (ABCP) programs” run by banks (“sponsor banks”).

Features of ABCP funding programs:

- Transaction volumes exceeding ca. €15 million; volumes exceeding €300 million may also be run via co-funding structures, in which two or more ABCP programs jointly finance a single pool.
- Liabilities in different currencies or jurisdictions can be bundled (e.g. when including a corporation’s foreign subsidiaries in a program).
- With regard to trade receivables, it is common practice to provide coverage via trade credit insurance in addition to structural credit enhancements (e.g. discounts on the purchase price, reserves, etc.).
- ABCP programs bundle the individual transactions, refinancing the total volume through the issue of short-term money-market papers, i.e. the ABCPs.
- The “sponsor banks” additionally provide liquidity lines to their ABCP programs. Their purpose to make liquidity available to the program, should it prove difficult to place sufficient ABCPs on the capital market or should transactions turn out to no longer be suitable for capital markets (e.g. in cases...
where the vendor has become bankrupt or other material events),

- Where an ABCP program’s liquidity lines cover not only the dilution risk but also the credit risk, one speaks of "fully-supported programs"; from a structural point of view these contrast greatly to other forms of asset-backed securities.

There is another aspect that should be taken into account: small companies (and new initiatives) are more likely to be financed through tranched securitised instruments, whereas medium size companies are in a better position to directly access capital markets. Consequently, to ensure participation of retail investors in the growth of capital markets, the data that must be provided by the issuers must be equally simple and transparent for investors.

- Refinancing of SME bank loans through securitisation

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, credit teams for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a show stopper; and the structurally lower visibility of a smaller business a real difficulty.

It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond – bearing however the limits of their embedded derivatives) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as of end 2012 the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIF report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. Pooling and standardisation of loans is needed to ensure transparency and comparability. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.

- Corporate bond markets
There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. There are three notable initiatives in Europe of this nature: the Initial Bond Offering launched by NYSE Euronext in 2012, modelled on equity IPOs; the German Bond M market create by the Stuttgart Stock Exchange in 2010; and the LSE ORB market launched in February 2010.

The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of theses mixed results.

There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly though the desired expansion of securitisation to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channelling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

4. Boosting Long-term Investments

In its 2012 advice, the SMSG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities as well as to private equity and venture capital funds. If pension funds covered by IORPDS would also have to comply with Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds' ability to invest into equity and other long-term assets, but may over time lead to companies being faced with increased costs for pension benefits, as pension funds find it difficult to generate the necessary long-term returns to match their long-term liabilities.

Given the plethora of investment funds in Europe (33000 versus 8000 in the US which is a more than twice bigger market), it will be difficult to justify the addition of yet further additional categories of long-term funds such as European Long Term Investment Funds (ELTIFs), European Venture Capital (EuVECA) and European Social Entrepreneurship Funds (EuSEF), and of a Pan-European personal pension plan ("29th regime") on the EU market, unless the industry and/or the regulators start streamlining, standardising and simplifying the other long term funds and individual investment product offerings. For example,
5. Developing a European Private Placement scheme

For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldschein) providing approximately €15 billion of debt in 2013.

The German Schuldscheindarlehen Market has a remarkable volume: EUR 68.7 bn with new issuance in 2014 of EUR 11.7 bn shows that Schuldscheindarlehen are a set financing instrument for especially medium sized enterprises (ca. 60% are non-listed companies) which should be considered as reference when thinking about European solutions. Investors have a buy and hold perspective which is also reflected in the average maturity (5.3 yrs).

Schuldscheindarlehen’s long track record with very low default rates and the required legal certainty makes the Schuldscheindarlehen an attractive asset class for investors. These markets provide financing through the use of so called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets. This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be privately placed to individual or small groups of institutional investors as in the case for example of reverse enquiry EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the European Private Placement Association (EU PPA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

Any increase in transaction costs, for example through further transparency requirements or an extension of the framework – like the LMA/ICMA standard requires – would make access to this funding instrument more difficult for SMEs.

This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-

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1. FCPR, FCPI, FCPE, PEP, OPCE, SICAF, SICAVAS, SCPL, SPPICAV
European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements. Most recently the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:

- Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.
- The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below-threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.
Detailed response to the Commission’s Green Paper

Improving SME access to finance:

The Green Paper’s analysis:

- for SMEs: diversity and scant credit information, preference to relationship based lending (hence banks);
- for start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring
- for mid-caps: access to public markets is costly
- Corporate bond markets lack transparency and standardisation
- Crowdfunding remains focused on national markets

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME’s access to finance and investor’s ability to invest.

- “Regulatory reconciliation”: is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e.g. CRD IV/CRR, MiFID II/MIFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.

- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them. Initiatives to promote financial literacy, to develop a capital market culture and to revive investor trust are needed.

- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.

- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to

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

early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital and other early stage fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

- Creation of public support specific to these companies (for example, subsidized credit lines).
- Commissioning a comparative review of the EU and US high yield debt markets with a specific focus on providing investors access to smaller companies at mutually attractive terms.
- Developing a flexible EU “bankruptcy regime” (similar to the Chapter 11 provisions in the US). Further harmonisation/standardisation/removal of barriers.

In addition the following tax incentives could be considered: if start-ups were allowed to off-set eg social charges against their tax-loss carry forwards which they typically accumulate during their early years of existence rather than eventually selling them off to a more mature company (who will use them to off-set tax on corporate profits), this would help reduce their overall funding needs in the beginning while allowing them to employ staff during critical growth stages of their development.

- Revive individual investors’ involvement in equity markets: in 1970 individual investors held directly close to 40% of EU listed companies, compared to about 13% today.
- Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment products by standardising, simplifying, streamlining and reducing the cost of - packaged investment products.

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?

When SMEs decide to use rating agencies, incentives, also for corporate debt rating, could be considered as follows:

- Reducing information asymmetries between issuers and investors and, as such, the risk premium demanded on loans to SMEs.
- Protecting investors, through the provision of additional information about the additional risks they are incurring with these types of investments.
- Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by recognized External Credit Assessment Institution (ECAI).
- Reducing costs by making the assets accepted as collateral in liquidity-providing operations to banks by the ECB, if the ratings are issued by recognized ECAI.

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

There should be two separate types of ELTIFs, those catering for the needs of institutional investors and those catering for the needs of retail investors. If all ELTIFs are modelled on the needs of retail investors (liquidity, investor protection etc) it risks making them unnecessarily expensive for the institutional investors.
any successful development of ELTIFs should consider:

- eliminating the plethora of already existing long term fund categories which are nationally incentivised (nine such categories existing in France alone, all with tax incentives);
- granting the “most favoured nation” clause to ELTIFs for its tax treatment in Member States;
- selling the same ELTIFs to all investors – retail or not, and ban funds of funds which add a layer of fees;
- applying the product disclosure rules of UCITS funds;
- making listed small cap equity an eligible asset class;
- allowing as well closed-end listed ELTIFs to address the liquidity issue;
- setting a high threshold for minimum investments in ELTIFs: those should be “advised” only to qualified and very financially literate investors.

Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFs have the potential to play an important role in capital market funding in the EU, if the right incentives for investors are there. Moreover, because they can play an important role in capital market funding in the EU, but they need more official support. One of the major barriers ELTIFs will face in trying to develop into a genuine cross-border fund structure, with a UCITS-like passport, is the lack of a level playing field for non-bank providers of credit when compared to bank lenders. Because ELTIFs are intended to invest in illiquid, often private (as opposed to public) assets, ELTIFs may need to operate only nationally if at all, given the various national restrictions on banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFs, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

- the inability of funds to originate loans;
- the need for a banking licence to originate loans;
- bank liabilities preferred on bankruptcy;
- the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
- restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
- different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

EU could undertake a review of the current obstacles to cross-border fundraising which have eg arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.
In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Corporate Private Placement Market Guide published on 11 February 2015), we suggest that a revision of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation (EU) 2015/35) should be considered. Although the final calibrations in the Delegated Act (the “long term guarantees package”) has helped remove obstacles to investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investment in private placements, as well as more generally in long-term assets.

Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

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

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, eg rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.

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?

Certainly, the 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improve and be set at par with those of equity markets. It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bonds markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap
borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues from the rest of the sector could come to resemble the more bespoke private placement market, on the other hand.

Consequently, it might be advisable to start with the standardisation of loans before developing standards on securitisation. Securitisation of SME would be better handled if loans are more accessible to investors, especially institutional investors.

The second step (or alternative approach to complete standardisation) should be to encourage standardisation of the criteria to monitor rather than the values to have access to capital markets.

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

As a preliminary comment, it is important to note that green bonds like any other listed bond come under the scope of existing financial regulation both at the EU and national levels. Green bonds are therefore not being issued in any form of regulatory void. They also benefit from a successful self-regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process represented by the GBP is preferable to a top-down normative approach leading for example to a green bond “label” formally recognised at a regulatory level. This would risk creating unnecessary market segmentation, as well as the perception of potential liabilities for issuers that could dissuade them from entering the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond market as they both experience additional costs compared to mainstream alternatives, and/or in order to maintain or accelerate the development of the market in support of wider public policy objectives related especially to the fight against climate change. The GBP require additional work from green bond issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g. dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green bonds and the underlying environmental projects. These costs are not reflected in the economics of green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal identified above of avoiding a top down normative approach to these securities.

At this stage, it is therefore most likely preferable to allow the green bond market to continue its development based on its current strong momentum and successful self-regulation (within the safeguards
provided by mainstream financial regulation). An active dialogue can be maintained on the need for possible future incentives between the Commission and national authorities on the one hand, and industry associations and self-regulatory initiatives on the other.

It is not necessary for the EU to take any legislative action for the development of Environment, Social and Governance ‘ESG’ investment. Numerous recent pieces of legislation introduce ESG disclosure requirements, such as country-by-country reporting, Revision of the Shareholders’ Rights Directive, efforts on conflict minerals, transparency requirements in the UCITS KIID and PRIIPs KID. The impact of these pieces of legislation now needs to be reviewed. However, the European Commission could play a role in the promotion of ESG. Finally, given the evolving nature of the industry, standardisation of processes should not be discussed at this point of time as market driven initiatives need to be given the space to grow.

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

The ESMA SMSG is in favour of the distinct and separate SME market regime under MiFID II and MAD

The SMSG believe that such a regime would have the following benefits:
- recognise the role such markets currently play in the EU funding environment;
- ensure that changes to EU financial services regulation do not adversely impact small caps;
- cater for a secondary market for trading shares of less liquid SMEs;
- allow for further development of regulatory and fiscal EU policies to attract investors to this asset class.

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 one of the emerging financing models that contribute to helping start-ups move up the “funding escalator”, as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refers to open calls to the wider public to raise funds for a specific project. These calls are often published and promoted through the internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds.
- Non financial crowdfunding, includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- Financial crowdfunding, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, *Understanding Alternative Finance*, Peter Baeck, Liam Collins, Bryan Zhang, November 2014 ) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.

Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects raise funds are themselves also relatively small business. According to the same Nesta report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200,000 pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no previous investment experience. Estimation of activity for the European Union is not easy, and overall figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax reliefs to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, rising awareness, etc.) addressed at promoting its usage as a financing vehicle,. ESMA recently published an Advice on Crowdfunding to European Parliament, Council, and Commission taking into account the need of promotion and clarification, while at the same time preserving investor protection at its highest


The main objective of the report is to assist NCA’s and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.

Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is
pure reception and transmission of orders, in which case a 50,000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission’s programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU–based platforms that could compete with the US ones.

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?

The ESMA SMSG insists on the need to avoid regulatory barriers to fluid markets such as FTT.

Regulatory convergence is also very important.

As developed in our reply to the Question 9, we believe that this should be harmonised in the EU-US trade relationships.

Supply side: institutional investors

The Green Paper’s analysis of current regulation and tools

UCITS V and AIFMD
- The directives are still insufficient to reduce cost and diversify managed funds investment.

On pensions and insurance:
- There could be a review of Solvency II (and CRR) delegated acts, to adapt prudential rules for identified sub-classed of lower-risk infrastructure investment.
- The Commission asks which sub-classes should be prioritised for.

On professional pensions:
- Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

Private equity and venture capital:
- EuVECA and EuSEF Regulations - the clause impeding managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
• Commission asks which measures could be proposed to: increase scale of venture capital funds (both via public and private contributions, improve exit strategies and supply for investors and boost supply of venture capital to start-ups.

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as these funds are typically closed-ended and unleveraged; if not - the €100 m threshold would apply ) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. However, the potential to be caught by AIFMD will [deter] funds from gaining scale [which is ultimately needed to allow a fund to diversify and achieve attractive] returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds >€100m compared to 227 in the US. The SMSG is aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequences in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive.

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU countries there are still institutional barriers to larger investments by eg pension funds, insurance funds etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so called prudent person rules.

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?

| Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given the lower liquidity of the underlying assets. |

There are 33 000 funds in the EU versus 800 in the US. The average size of an EU fund is about €200 million versus €1600 million in the US, i.e. 8 times bigger. The annual fees of EU equity funds are 170 bps (2011: last available info) versus 74 bps in the US (2013).

3 Earlybird Europe Venture Capital Report – July 2011
The number of funds must be drastically reduced, especially AIFs as they are more numerous (about 20,000), smaller and often only distributed on a national basis. For example, Better Finance is proposing to ban AIFs in retail packaged products such as unit-linked insurance contracts and pension plans, in favour of UCITs.

For individual EU investors the problem is compounded by the fact that direct fund holdings account for only 7% of their financial assets: most economic retail ownership of funds is through wrappers that add yet another layer of costs further reducing the net returns to EU citizens.

Review of the tightening of the national private placement regimes for cross-border marketing of especially below threshold funds that followed as a result of the implementation of the AIFMD. Review of the practice of many national CAs to impose additional charges and/or additional conditions (like a French paying agent) for managers who have already been granted the EU-passport in their home jurisdiction.

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 CRD IV/CRR and Solvency II?

EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any future proposals to introduce similar regulation for pension funds must not place conditions that adversely impact the ability to directly or indirectly invest in small caps. The capital and liquidity requirements under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest and most liquid blue-chip equities or even only interest bearing instruments like government bonds due to the lower risk weightings for these than equities in general and deter any existing appetite for smaller companies. An appropriate exemption for direct or indirect investment in small cap securities should be implemented.

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

Yes

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?

The European Venture Capital Funds Regulation (EVC FR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes holdings in SME markets as ‘qualifying portfolio companies’. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor
need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest institutions do) nor have necessarily worked in the financial industry.

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?

As mentioned above through not imposing overly restrictive capital requirements not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class.

Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor.

Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company’s development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the “valley of death”...

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

- Commission asks how to increase participation in UCITS by cross-border retail;
- Share best national best practices in the development of simple and transparent investment products for consumers;
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

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

Review of UCITS directive to identify ways to attract dedicated UCIT funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the advantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make investments directly in SME issuers.

UCITS are much more cross-border than AIFs already because the two major domiciles for UCITS are largely “off-shore”: Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross-border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).

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

ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better enforce existing investor protection rules. For all this they need their resources to grow, not to be cut.

Each ESA should be given the necessary resources to build a Single Rulebook for the sector it supervises. A level playing field for financial products services regulated by the three ESAs is essential for ensuring consumer and investor protection.

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

General comment
The savings rate of household is already quite high in Europe. Also, contrary to what one often reads, individual investors are not more short term nor more risk averse than other investors:
- 62% of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80% of their total savings are long term if property is taken into account.
- DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans [Swedish, French and US evidence at least]
- By contrast, Western European insurers have lowered their own risk equity investments from 22 to 8% from 2001 to 2010: way before Solvency II.
- The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.
- The involvement of individual investors in SME markets is about twice as large as it is in blue chips.
- What individual investors do not like it high risk – low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the fists category returned a net real after tx return of 20% since 2000, the latter a negative one of minus 14% over the same period.

- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.
- Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax offsetting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.
- Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected they will be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders’ voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.
• Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.

• Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.

One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax deductible expenses for a company and then taxed in the hands of the recipient, dividends are subject to double taxation (made out of taxed corporate profits and then taxed again in the hands of investors).

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

To our knowledge, the longer term the retail investment products are the more complex. This is why a simple, standardized Pan-European personal pension plan is needed.

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

Yes:
- The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further standardize and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance Mediation and IORP Directives should be amended in order to make their summary documents more standardised, simpler, shorter, in Plain English and more comparable between each other and with other investment products.
- IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.
Supply side – non-EU investment

Attracting non-EU investment:

- The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
- The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

EU needs to continue to ensure “reciprocity”, i.e. not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market internationally.

Given that many regulatory initiatives are newly implemented in Europe, and taking into account that markets have become global, the topic of third-country recognition is important. In general, the same level of requirements for third-country enterprises providing their services in a European Member State should be maintained in order to preserve the desired standards of services in the EU. The potentially lower standards from third countries for the same services should not be introduced via recognition procedures. This is particularly sensitive with regard to foreign competition, affecting the growth potential for EU companies.

Therefore, a fair balance needs to be found to allow non-EU companies to provide their services in Europe.

It is important to ensure that global standards and rules put in place by institutions such as the International Organization of Securities Commissions, the Bank for International Settlements and the Financial Stability Board are carefully considered when drafting regulation in order to avoid regulatory arbitrage that could have negative consequences for growth. Safety standards, risk mitigation measures and data protection rules, for example, should be put in place at the highest level possible. A “race to the bottom” should be avoided, so that individual players cannot exploit weak regulatory regimes. Isolated national regulation should be avoided as well.

On the other hand, it is important that European companies are allowed to enter third country markets to provide services abroad. It should be noted that other countries may have high barriers of access to their markets, which is another reason to consider initiatives to ensure that EU market participants are able to offer their services outside the EU on a level playing field with non-EU providers.

In this regard, reciprocity should be requested and maintained with regard to third-country regimes.

The Green Paper focuses solely on the access of EU firms to international markets. The CMU should also take into account the access to the Internal Market by international investors from the EU’s key partner countries. In this regard, the following proposals should be taken into account:
• The EU Commission should take account of the impact of cross-border capital flows in its Impact Assessments when it is developing new proposals. To do this effectively, the views of non-EU partners should be sought in formal dialogues. Through these dialogues, non-EU partner country authorities should be allowed to play an active and constructive role in the development of the CMU to help ensure regulatory coherence and avoid closing borders to investors and financial services.

• The Commission should proactively involve third-country regulators in the development of the CMU action plan to ensure CMU is devised in a way that does not erect barriers around the single market.

• To avoid regulatory arbitrage, the Commission should proactively work with partner countries to develop new international standards and implement them effectively and consistently – as was the case with the OECD standard on Automatic Exchange of Information in tax matters, but less so with the implementation of Basel III, which was not wholly consistent.

• The EU should aim to work with IOSCO to develop standards that can internationalise the measures in the capital markets union, in an effort to replicate the success of the OECD in the tax field, and the BIS in the prudential. If some jurisdictions are not prepared to work to IOSCO standards, this should not prevent the EU from developing them with other jurisdictions.

• One of the objectives of CMU should be the development and putting into practice of an improved regime for assessing equivalence with partner countries. This needs to be both pragmatic and predictable, providing a coherent approach in the equivalence determination. The regime needs to take account of the different regulatory environments and approaches in partner countries, eschewing a one-size-fits-all approach, and instead providing for flexibility on the basis of agreed principles. Where the Commission deviates from ESMA advice, it should explain its reasoning, and make clear in advance the criteria it will use to make equivalence decisions, thus providing the market with a higher degree of predictability.

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?
Improving the investment chain

Commission’s analysis regarding the single rule book, enforcement and competition includes:

• The single rulebook is a major step forward to enforce EU regulation consistently but the single rulebook’s success depends on consistent implementation and enforcement.
• Supervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
• Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
• Market infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

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

Regulatory reconciliation is a key in the next years.

The Capital Markets Union should ensure that the long-term goal is to reduce the regulatory burden to what is essential. Additionally, loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences.

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?

Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to “crack-down” on national CAs who go further than what has been envisaged under certain Directives?

In relation to ESMA, consistent supervision can be enforced with the implementation of its guidelines through peer reviews and consistent application across the 28 Member States.

ESMA should also prioritise the promotion of unified reporting requirements.

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?

The overall legal framework for securities varies widely by country. For example, legal barriers make it much more complex to hold securities cross-border, and lead to higher costs for transactions. In addition, they cause difficulties and uncertainty among investors when they exercise their rights abroad.
Given that legal uncertainty of this nature acts as a barrier to financial stability and growth, the European Commission has been examining barriers within securities markets for several years, with the aim of creating a stable and efficiently functioning single market.

Continued harmonisation of rules and standards is essential to eliminate costly barriers and reduce complexity for investors and companies. Initiatives in this area, building on the Single Rulebook as a harmonised regulatory framework, should increase the attractiveness and returns on investment, thereby stimulating economic growth.

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?

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?

Without common applied corporate governance principles/control the Union cannot be done successfully. Thus further harmonisation of national rules and standards are needed in order to eliminate costly barriers and reduce complexity for investors is essential.

The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and size) company statutory reporting info for the last 12 years is available (for purchase) via the web-site www.allabolag.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

Language is another impediment.

Despite significant progress towards the European single market, capital markets are still fragmented with regard to company law, corporate governance rules, creating barriers that hamper the free flow of capital. Those barriers across regions make cross-border investments complex and expensive, and therefore less attractive. The Single Rulebook has not yet been fully achieved.

Continued harmonisation of national rules and standards in order to eliminate costly barriers and reduce complexity for investors is essential.

The exercise of cross-border voting rights and the operational complexity of the voting chain is an obstacle to integrated capital markets arising from company law and corporate governance.

In addition, the concept of differential/enhanced voting rights, introduced in some Member States, could impact cross-border investment flows, one of the key objectives of a Capital Markets Union. It would favour majority shareholders, often domestic entities over minority shareholders, generally cross-border large and individual shareholders.

A consistent legal framework for creditor protection and insolvency across the EU would also facilitate cross-border investment.
29) What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

Different national insolvency laws make cross-border services expensive. Reducing the existing inefficiencies will play an important role in unleashing the wider macroeconomic benefits from integrating European securities markets.

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?

- Eliminate the double taxation of cross-border dividends and interests within the EU and end tax discriminations against EU investors domiciled in another Member state than the investment provider.

- Review of EU State Aid risk capital guidelines to allow for effective incentive schemes to be adopted by Member States. The guidelines should recognise the role of expansion capital as genuine risk capital. Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Exemption of certain investment rules imposed on certain investors in the case of investments in SMEs (e.g., minimum ratings, liquidity of securities, etc.). This would need to be balanced with any risk of misallocation of capital.

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?
MiFID has posed serious challenges to the bank and broker intermediation chain potentially harming local funding ecosystems.

With regard to Regulated Markets and MTFs, the increased transparency included in regulation such as MiFID represents a challenge for SMEs, resulting in a suboptimal time allocation for SMEs’ board and management and ensuing increased costs of accessing public markets. In addition, MiFID has also heightened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the Uk in 2014, where it now counts 33 participants.

Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a “work zone” supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is “capital neutral” to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.

It is made up of different phases:

- 1st phase - GET READY: It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities;
- 2nd phase - GET FIT: New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support, where appropriate, of a dedicated external advisory team;
- 3rd phase – GET VALUE: Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European ELITE community of advisers, investors and stakeholders.

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The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.

Transaction costs should be lowered towards the US level.

Actual consolidated tape – free for individual investors after a few minutes – should be now eventually enforced in Europe. A debate on the consolidated tape, as included in the data and reporting section, should be addressed within MiFID II. Article 90.2 MiFID II even includes a review clause for the CTP regime. To avoid double regulation, it is strongly recommended to delete the part on consolidated tape.

Please avoid wording “consolidated tape” as this has a different meaning in context of MiFID. Suggest to ask for retail data provided by investment firms that delivers investment services to retail customers to ensure best execution (and verification).

Please add clarification and to avoid double regulation.
ESMA Securities Markets Stakeholder Group
Contribution to the Green Paper “Building a Capital Markets Union” (CMU)

In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises’ (SME) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium sized companies to have access to funding (through private equity and venture capital funds or through capital markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Please note that the document is structured into three distinct parts:
• The SMSG’s preliminary comments
• The SMSG’s comments on the Commission’s 5 priorities for short terms action
• The SMSG’s detailed comments on the Green Paper’s questions

PRELIMINARY COMMENTS

In its initial advice, the SMSG stressed that using capital markets bring many advantages to SMEs including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they are able to provide (in light of Basel III, possibly the Volcker Rule, the future structure of banking paper etc.) that would make it increasingly more difficult to extend loans to SMEs. The development of the Capital Markets Union may promote alternative funding sources (both equity and debt), to facilitate growth. There is not just one method through which to increase access to funding for SMEs: Fostering a stable, positive environment and incentivising companies through attractive and diverse funding options is essential. In its 2012 report, the SMSG concluded that regulatory initiatives often have a negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that there is a need to focus on how to provide to each category of investors the right incentives to encourage this broad community to invest not only in equity but also in debt issued by smaller companies and how to structure an efficient, transparent and competitive market so that investors can get reliable liquidity in their investments. This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens as individual investors. In addition, the state of development of capital markets, the needs, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed in the EU. It is likewise important that actions focus on the financial sector as a whole and widen and deepen European capital markets, across not only the euro countries, as in the Banking Union, but across all 28 EU Member States, not as a set of silos.
In order to achieve the objectives of the Capital Markets Union, it is essential to develop initiatives to restore investor trust and confidence, in order to revive demand for new sources of funding. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available across Member States.

**THE GREEN PAPER IDENTIFIES FIVE PRIORITY AREAS FOR SHORT TERM ACTION INCLUDING THE FOLLOWING SCHEMES:**

1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;
2. Widening the investor base for SME and improving credit information on SME;
3. Building sustainable securitisation;
4. Boosting long-term investment;
5. Developing European private placement

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:

1. **The Prospectus regime - lowering barriers to accessing capital markets**

   An effective overall funding environment in Europe must seek to:

   - Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.
   - Attract a wider set of investors to smaller or growing businesses or innovation through financing of "research and development programs" by reducing the regulatory and fiscal burden especially on such investors that invest in SME investors.

   The SMSG SME believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no 'one-size fits all' solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SMSG SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

   - More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.
   - Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS) - should be optional for SMEs. For companies listed at the regulated market there should be no ex-
exceptions, but if a company listed on the SME market applies simplified IFRS standards, and then decides to enter a regulated market, such simplified IFRS reports could be treated as equivalent to “full” IFRS reports in the meaning of the IFRS 1—as comparable reports without a necessity to prepare “restated” financial statements covering the latest 3 financial periods.

- Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.

- Pre-IPO registration process—prior to the formal offer of securities—would help issuers take advantage of the relatively short term ‘IPO window’. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.

- Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and or key adviser. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained. To be fully effective, such a “delegated” prospectus should be treated as the first step to the regulated market. It means that if after the initial period on the SME market such a company grows enough to be listed on a fully regulated market, requirements for the new prospectus should be at least partially satisfied with that initial prospectus, at least by calling it by reference.

- EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMEs. In its current form, the Prospectus—and in particular the “Summary Prospectus” —is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

Alongside investor interests for standardized credit data, a further focus must be put on taking the interests of small companies and small banks such as savings and cooperative banks into account, i.e. the ones having to provide such data. A European solution for company data needs to be designed in such a way that any provision of data takes place on a voluntary and not a mandatory basis, i.e. only when a company is interested in gaining access to larger and international investor groups in the context of funding measures via the capital markets.
Valuation: Standardized credit scorings can help to reduce information asymmetries. Though at the same time highly redundant business models based on standardized credit scorings and ratings can lead to significant systemic risks. Therefore investors need also to take on responsibility themselves for adequate risk assessments of their exposure.

3. Securitisation and corporate debt - building debt market financing for SMEs

When exploring the topic of fixed income market financing for SMEs, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an additional definition for the 'Entreprises de Taille Intermediaire' which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally. Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies.

Further, in the context of the creation of new securities (e.g. private placements), the use of market infrastructures should be promoted, as they increase stability, by using safe, stable and reliable electronic systems, allowing e.g. for notary functions and reconciliation measures (i.e. ensuring integrity of the issue). Services provided by market infrastructures further facilitate an extensive international investors’ reach: not only domestic investors are reached, but also investors on a European and global level may be reached. This reduces the “home-bias” phenomenon.

Alongside banks, companies operating in the real economy also make use of asset-backed securities to gain funding on the capital market. Such securities play an important role for companies, offering advantages – alongside being an attractive way of gaining funding – with regard to corporate indicators, credit line utilization and reporting requirements not available when using other capital market products.

Asset-backed receivables in the form of trade, financing or leasing receivables (the latter generally coming from corporate sales funding subsidiaries) are for the most part sold to so-called “asset-backed commercial paper (ABCP) programs” run by banks (“sponsor banks”).

Features of ABCP funding programs:

- Transaction volumes exceeding ca. €15 million; volumes exceeding €300 million may also be run via co-funding structures, in which two or more ABCP programs jointly finance a single pool.
- Liabilities in different currencies or jurisdictions can be bundled (e.g. when including a corporation’s foreign subsidiaries in a program).
- With regard to trade receivables, it is common practice to provide coverage via trade credit insurance in addition to structural credit enhancements (e.g. discounts on the purchase price, reserves, etc.).
• ABCP programs bundle the individual transactions, refinancing the total volume through the issue of short-term money-market papers, i.e. the ABCPs.

• The “sponsor banks” additionally provide liquidity lines to their ABCP programs. Their purpose to make liquidity available to the program, should it prove difficult to place sufficient ABCPs on the capital market or should transactions turn out to no longer be suitable for capital markets (e.g. in cases where the vendor has become bankrupt or other material events).

• Where an ABCP program’s liquidity lines cover not only the dilution risk but also the credit risk, one speaks of “fully-supported programs”; from a structural point of view these contrast greatly to other forms of asset-backed securities.

There is another aspect that should be taken into account: small companies (and new initiatives) are more likely to be financed through tranched securitised instruments, whereas medium size companies are in a better position to directly access capital markets. Consequently, to ensure participation of retail investors in the growth of capital markets, the data that must be provided by the issuers must be equally simple and transparent for investors.

**Refinancing of SME bank loans through securitisation**

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, credit teams for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a show stopper; and the structurally lower visibility of a smaller business a real difficulty.

It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond – bearing however the limits of their embedded derivatives) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as of end 2012 the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIF report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance
and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. Pooling and standardisation of loans is needed to ensure transparency and comparability. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.
Corporate bond markets

There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. There are three notable initiatives in Europe of this nature: the Initial Bond Offering launched by NYSE Euronext in 2012, modelled on equity IPOs; the German Bond M market created by the Stuttgart Stock Exchange in 2010; and the LSE ORB market launched in February 2010.

The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of these mixed results.

There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly through the desired expansion of securitisation to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channelling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

4. Boosting Long-term Investments

In its 2012 advice, the SMSG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities as well as to private equity and venture capital funds. If pension funds covered by IORPDS would also have to comply with Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds’ ability to invest into equity and other long-term assets, but may over time lead to companies being faced with increased costs for pension benefits, as pension funds find it difficult to generate the necessary long-term returns to match their long-term liabilities.

Given the plethora of investment funds in Europe (33000 versus 8000 in the US which is a more than twice bigger market), it will be difficult to justify the addition of yet further additional categories of long term funds such as European Long Term Investment Funds (ELTIFs), European Venture Capital (EuVECA)
5. Developing a European Private Placement scheme

For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldhein) providing approximately €15 billion of debt in 2013. The German Schuldscheindarlehen Market has a remarkable volume: EUR 68.7 bn with new issuance in 2014 of EUR 13.7 bn shows that Schuldscheindarlehen are a set financing instrument for especially medium sized enterprises (ca. 60% are non-listed companies) which should be considered as reference when thinking about European solutions. Investors have a buy and hold perspective which is also reflected in the average maturity (5.3 yrs).

It’s long track record with very low default rates and the required legal certainty makes the Schuldscheindarlehen an attractive asset class for investors.

These markets provide financing through the use of so called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be “privately placed” to individual or small groups of institutional investors as in the case for example of reverse enquiry EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the European Private Placement Association (EU PPA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

Any increase in transaction costs, for example through further transparency requirements or an extension of the framework – like the LMA/ICMA standard requires –, would make access to this funding instrument more difficult for SMEs.

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1 FCPR, FCPL, FCPE, FEP, OPCI, SICAF, SICAVAS, SCPI, SPPICAV
This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements. Most recently the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:

- Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.
- The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.
Detailed response to the Commission’s Green Paper

Improving SME access to finance:

The Green Paper’s analysis:
- for SMEs: diversity and scant credit information, preference to relationship based lending (hence banks);
- for start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring
- for mid-caps: access to public markets is costly
- Corporate bond markets lack transparency and standardisation
- Crowdfunding remains focused on national markets

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

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME’s access to finance and investor’s ability to invest.
- “Regulatory reconciliation”: is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e. g. CRD IV/CRR, MiFID II/MiFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.
- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them. Initiatives to promote financial literacy, to develop a capital market culture and to revive investor trust are needed.
- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.
- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to

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

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME’s access to finance and investor’s ability to invest.
- “Regulatory reconciliation”: is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e. g. CRD IV/CRR, MiFID II/MiFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.
- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them. Initiatives to promote financial literacy, to develop a capital market culture and to revive investor trust are needed.
- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.
- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to
early stage/small cap investors. This assessment increases the cost of investment and disenfran-
chises an important set of investors from small caps. A review would also help to ensure that appro-
priate exemptions are made for venture capital and other early stage fund managers (and their end
investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

- Creation of public support specific to these companies (for example, subsidized credit lines).
- Commissioning a comparative review of the EU and US high yield debt markets with a specific focus
  on providing investors access to smaller companies at mutually attractive terms.
- Developing a flexible EU “bankruptcy regime” (similar to the Chapter 11 provisions in the US). Fur-
  ther harmonisation/standardisation/removal of barriers.
- In addition the following tax incentives could be considered: If start-ups were allowed to off-set eg
  social charges against their tax-loss carry forwards which they typically accumulate during their early
  years of existence rather than eventually selling them off to a more mature company (who will use
  them to off-set tax on corporate profits), this would help reduce their overall funding needs in the
  beginning while allowing them to employ staff during critical growth stages of their development.
- Revive individual investors’ involvement in equity markets: in 1970 individual investors held directly
  close to 40 % of EU listed companies, compared to about 13 % today.
- Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment
  products by standardising, simplifying, streamlining and reducing the cost of - packaged investment
  products.

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

When SMEs decide to userating agencies, incentives, also for corporate debt rating, could be considered
as follows:

- Reducing information asymmetries between issuers and investors and, as such, the risk premium
demanded on loans to SMEs.
- Protecting investors, through the provision of additional information about the additional risks they
  are incurring with these types of investments.
- Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by
  recognized External Credit Assessment Institution (ECAI).
- Reducing costs by making the assets accepted as collateral in liquidity-providing operations to banks
  by the ECB, if the ratings are issued by recognized ECAI.

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

There should be two separate types of ELTIFs, those catering for the needs of institutional investors and
those catering for the needs of retail investors. If all ELTIFs are modelled on the needs of retail investors
(liquidity; investor protection etc) it risks making them unnecessarily expensive for the institutional
investors.

Any successful development of ELTIFs should consider:

- eliminating the plethora of already existing long term fund categories which are nationally incentiv-
  ised (nine such categories existing in France alone, all with tax incentives).
• Granting the “most favoured nation” clause to ELTIFs for its tax treatment in Member States
• Selling the same ELTIFs to all investors — retail or not, and ban funds of funds which add a layer of fees
• Applying the product disclosure rules of UCITS funds;
• Making listed small cap equity an eligible asset class.
• allowing as well closed-end listed ELTIFs to address the liquidity issue
• Setting a high threshold for minimum investments in ELTIFs: those should be “advised” only to qualified and very financially literate investors.

Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFs have the potential to play an important role in capital market funding in the EU, if the right incentives for investors are there. Moreover, because they can play an important role in capital market funding in the EU, but they need more official support. One of the major barriers ELTIFs will face in trying to develop up into a genuine cross-border fund structure, with a UCITS-like passport, is the lack of a level playing field for non-bank providers of credit when compared to bank lenders. Because ELTIFs are intended to invest in illiquid, often private (as opposed to public) assets, ELTIFs may need to operate only nationally if at all, given the various national restrictions on banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFs, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

• the inability of funds to originate loans;
• the need for a banking licence to originate loans;
• bank liabilities preferred on bankruptcy;
• the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
• restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
• different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

EU could undertake a review of the current obstacles to cross-border fundraising which have eg arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.

In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Corporate Private Placement Market Guide published on 11 February 2015 ), we suggest that a review of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation (EU) 2015/35) should be considered. Although the final calibrations in the Delegated Act (the “long term guarantees package”) has helped remove obstacles to

The discretion of the asset manager to choose whether to open the ELTIF to retail investors or not along with the discretion as to the minimum investment and the early redemption rights are welcome. Still, additional effort should be made to attract particular categories of investors such as:
- Small pension plans and local associations that have the capacity (or are sometimes even required) to lock up some of their capital for a period and to diversify their portfolio beyond cash and high liquid securities. As those investors are classified as retail investors, they will be excluded from a number of ELTIFs open only to professional investors, whereas the request to be treated as professional investors based on the MIFID criteria is not relevant to them as it might generate too high a legal hurdle and important costs for them.
- Insurance companies who again wish to further diversify their portfolios, but investment on long-term illiquid assets such as infrastructure or non-listed SMEs are “penalised” as to the important capital requirements they bring.

Moreover additional flexibility when it comes to the lifetime of the ELTIF in order to make it possible to adapt to the changes in the long-term landscape of its investment strategy, would make it feasible for ELTIFs to take advantage of market opportunities to the benefit of their investors.

Apart from the need to deliver a regulatory framework of ELTIFs able to meet their investors’ needs, it should be stressed that their market potential will be linked to a great extent to the general regulatory environment. Ensuring that substantial incentives are in place includes also the provision of tax incentives and the removal of any fiscal or administrative barriers. Moreover, investors need and seek stable and predictable regulatory environments. This prerequisite becomes even more relevant in the case of illiquid investments, in which the link to a particular jurisdiction is of longer duration. Finally, education on financial principles and tools for retail investors will help them understand the risks associated with the financing of a long-term project and the economic and social benefits.

Proposal to replace this part by: At the same time a single set of rules for all types of investors (retail, or professional; small, medium- or large-) will fail to recognise different needs of such a wide range of investors or of a wide range of eligible assets, ELTIFs seek to attract. Therefore, the possibility to adapt the structure on the different needs of the investors’ base of each ELTIF is necessary to increase their market attractiveness and fully their success in financing of the long-term needs for growth of the EU economy.

Proposal to delete this part
investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investment in private placements, as well as more generally in long-term assets.

Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

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

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, eg rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.

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?

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets. It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bonds markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues from the rest of the sector could come to resemble the more bespoke private placement market, on the other hand. Consequently, it might be advisable to start with the standardisation of loans before developing standards on securitisation. Securitisation of SME would be better handled if loans are more
accessible to investors, especially institutional investors. The second step (or alternative approach to complete standardisation) should be to encourage standardisation of the criteria to monitor rather than the values to have access to capital markets.

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

As a preliminary comment, it is important to note that green bonds like any other listed bond come under the scope of existing financial regulation both at the EU and national levels. Green bonds are therefore not being issued in any form of regulatory void. They also benefit from a successful self-regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process represented by the GBP is preferable to a top-down normative approach leading for example to a green bond “label” formally recognized at a regulatory level. This would risk creating unnecessary market segmentation, as well as the perception of potential liabilities for issuers that could dissuade them from entering the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond market as they both experience additional costs compared to mainstream alternatives, and/or in order to maintain or accelerate the development of the market in support of wider public policy objectives related especially to the fight against climate change. The GBP require additional work from green bond issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g. dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green bonds and the underlying environmental projects. These costs are not reflected in the economics of green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal identified above of avoiding a top down normative approach to these securities.

At this stage, it is therefore most likely preferable to allow the green bond market to continue its development based on its current strong momentum and successful self-regulation (within the safeguards provided by mainstream financial regulation). An active dialogue can be maintained on the need for possible future incentives between the Commission and national authorities on the one hand, and industry associations and self-regulatory initiatives on the other.

It is not necessary for the EU to take any legislative action for the development of Environment, Social and Governance ‘ESG’ investment. Numerous recent pieces of legislation introduce ESG disclosure requirements, such as country-by-country reporting, Revision of the Shareholders’ Rights Directive, efforts on conflict minerals, transparency requirements in the UCITS KIID and PRIIPs KID. The impact of these pieces of legislation now needs to be reviewed. However, the European Commission could play a role in
the promotion of ESG. Finally, given the evolving nature of the industry, standardisation of processes should not be discussed at this point of time as market driven initiatives need to be given the space to grow.

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

- Such a common EU level accounting standard, consistent with a simplified IFRS standard could be treated as the first step to the fully regulated market. If a company listed on an MTF decides to prepare (on the optional basis) to prepare its reports according to that standard, and then decides to enter a regulated market, such simplified IFRS reports could be treated as equivalent to “full” IFRS reports in the meaning of the IFRS 1 – as comparable reports without a necessity to prepare “restated” financial statements covering the latest 3 financial periods. Such a solution could help in lowering costs of transfer from an MTF to the regulated market.

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 one of the emerging financing models that contribute to helping start-ups move up the “funding escalator”, as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refers to open calls to the wider public to raise funds for a specific project. These calls are often published and promoted through the internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds:

- Non financial crowdfunding, includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- Financial crowdfunding, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure
representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, Understanding Alternative Finance, Peter Baek, Liam Collins, Bryan Zhang, November 2014) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.

Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects raise funds are themselves also relatively small business. According to the same Nesta report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200,000 pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no previous investment experience. Estimation of activity for the European Union is not easy, and overall figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax reliefs to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, rising awareness, etc.) addressed at promoting its usage as a financing vehicle.

The main objective of the report is to assist NCA’s and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.

Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is pure reception and transmission of orders, in which case a 50,000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission’s programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU–based platforms that could compete with the US ones.

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?

- The ESMA SMSG insists on the need to avoid regulatory barriers to fluid markets such as FTT.
- Regulatory convergence is also very important.
- As developed in our reply to the Question 9, we believe that this should be harmonised in the EU-US trade relationships.
Supply side: institutional investors

The Green Paper’s analysis of current regulation and tools
UCITS V and AIFMD
• The directives are still insufficient to reduce cost and diversify managed funds investment.

On pensions and insurance:
• There could be a review of Solvency II (and CRR) delegated acts, to adapt prudential rules for identified sub-classed of lower-risk infrastructure investment.
• The Commission asks which sub-classes should be prioritised for.

On professional pensions:
• Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

Private equity and venture capital:
• EuVECA and EuSEF Regulations - the clause impeding managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
• Commission asks which measures could be proposed to: increase scale of venture capital funds (both via public and private contributions, improve exit strategies and supply for investors and boost supply of venture capital to start ups).

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as these funds are typically closed-ended and unleveraged; if not - the €100 m threshold would apply ) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. However, the potential to be caught by AIFMD will deter funds from gaining scale which is ultimately needed to allow a fund to diversify and achieve attractive returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds $100m compared to 227 in the US. The SMSG is aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequences in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive.

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU

1 Earlybird Europe Venture Capital Report – July 2011
countries there are still institutional barriers to larger investments by eg pension funds, insurance funds etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so called prudent person rules.

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?

- Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given the lower liquidity of the underlying assets.

- There are 33,000 funds in the EU versus 800 in the US. The average size of an EU fund is about € 200 million versus € 1600 million in the US, i.e. 8 times bigger. The annual fees of EU equity funds are 1701 bps (2011: last available info) versus 74 bps in the US (2013)

- The number of funds must be drastically reduced, especially AIFs as they are more numerous (about 20,000), smaller and often only distributed on a national basis. For example, Better Finance is proposing to ban AIFs in retail packaged products such as unit-linked insurance contracts and pension plans, in favour of UCITs.

- For individual EU investors the problem is compounded by the fact that direct fund holdings account for only 7% of their financial assets: most economic retail ownership of funds is through wrappers that add yet another layer of costs further reducing the net returns to EU citizens.

- Review of the tightening of the national private placement regimes for cross-border marketing of especially below threshold funds that followed as a result of the implementation of the AIFMD. Review of the practice of many national CAs to impose additional charges and/or additional conditions (like a French paying agent) for managers who have already been granted the EU-passport in their home jurisdiction.

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?

- EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any future proposals to introduce similar regulation for pension funds must not place conditions that adversely impact the ability to directly or indirectly invest in small caps.

- The capital and liquidity requirements under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest and most liquid blue-chip equities or even only interest bearing instruments like government bonds due to the lower risk weightings for these than equities in general and deter any existing appetite for smaller companies.

- An appropriate exemption for direct or indirect investment in small cap securities should be implemented.
13) Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

Yes

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?

The European Venture Capital Funds Regulation (EVCFR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes holdings in SME markets as ‘qualifying portfolio companies’. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest institutions do) nor have necessarily worked in the financial industry.

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?

- As mentioned above through not imposing overly restrictive capital requirement, not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class.
- Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor.
- Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company’s development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the “valley of death”...

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

- Commission asks how to increase participation in UCITS by cross-border retail;
- Share best national best practices in the development of simple and transparent investment products for consumers;
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

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

- Review of UCITS directive to identify ways to attract dedicated UCIT funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the advantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make investments directly in SME issuers.
- UCITS are much more cross-border than AIFs already because the two major domiciles for UCITs are largely "off-shore": Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross-border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).

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

- ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better enforce existing investor protection rules.
- For all this they need their resources to grow, not to be cut. Each ESA should be given the necessary resources to build a Single Rulebook for the sector it supervises.
- A level playing field for financial products services regulated by the three ESAs is essential for ensuring consumer and investor protection.

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

General comment

The savings rate of household is already quite high in Europe. Also, contrary to what one often reads, individual investors are not more short terms nor more risk averse than other investors:
• 62 % of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80 % of their total savings are long term if property is taken into account.

• DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least)

• By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8 % from 2001 to 2010: way before Solvency II.

• The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.

• The involvement of individual investors in SME markets is about twice as large as it is in blue chips

• What individual investors do not like it high risk – low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the first category returned a net real after tx return of 20 % since 2000, the latter a negative one of minus 14 % over the same period.

• Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

• Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.

• Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected they will be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders’ voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.

• Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.

• Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.
• One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax deductible expenses for a company and then taxed in the hands of the recipient, dividends are subject to double taxation (made out of taxed corporate profits and then taxed again in the hands of investors).

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

To our knowledge, the longer term the investment products are the more complex. This is why a simple, standardized Pan-European personal pension plan is needed.

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

• The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further standardise and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance Mediation and IORP Directives should be amended in order to make their summary documents more standardised, simpler, shorter, in Plain English and more comparable between each other and with other investment products.
• IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
• The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.

What about the UK’s Simple Financial Products Initiative?
Supply side – non-EU investment

Attracting non-EU investment:

- The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
- The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

EU needs to continue to ensure “reciprocity”, i.e. not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market internationally.

- Given that many regulatory initiatives are newly implemented in Europe, and taking into account that markets have become global, the topic of third-country recognition is important. In general, the same level of requirements for third-country enterprises providing their services in a European Member State should be maintained in order to preserve the desired standards of services in the EU. The potentially lower standards from third countries for the same services should not be introduced via recognition procedures. This is particularly sensitive with regard to foreign competition, affecting the growth potential for EU companies.

- Therefore, a fair balance needs to be found to allow non-EU companies to provide their services in Europe.

- It is important to ensure that global standards and rules put in place by institutions such as the International Organization of Securities Commissions, the Bank for International Settlements and the Financial Stability Board are carefully considered when drafting regulation in order to avoid regulatory arbitrage that could have negative consequences for growth. Safety standards, risk mitigation measures and data protection rules, for example, should be put in place at the highest level possible. A “race to the bottom” should be avoided, so that individual players cannot exploit weak regulatory regimes. Isolated national regulation should be avoided as well.

- On the other hand, it is important that European companies are allowed to enter third country markets to provide services abroad. It should be noted that other countries may have high barriers of access to their markets, which is another reason to consider initiatives to ensure that EU market participants are able to offer their services outside the EU on a level playing field with non-EU providers.

The Green Paper focuses solely on the access of EU firms to international markets. The CMU should also take into account the access to the Internal Market by international investors from the EU’s key partner countries. In this regard, the following proposals should be taken into account:
• The EU Commission should take account of the impact of cross-border capital flows in its Impact Assessments when it is developing new proposals. To do this effectively, the views of non-EU partners should be sought in formal dialogues. Through these dialogues, non-EU partner country authorities should be allowed to play an active and constructive role in the development of the CMU to help ensure regulatory coherence and avoid closing borders to investors and financial services.

• The Commission should proactively involve third-country regulators in the development of the CMU action plan to ensure CMU is devised in a way that does not erect barriers around the single market.

• To avoid regulatory arbitrage, the Commission should proactively work with partner countries to develop new international standards and implement them effectively and consistently as was the case with the OECD standard on Automatic Exchange of Information in tax matters, but less so with the implementation of Basel III, which was not wholly consistent.

• The EU should aim to work with IOSCO to develop standards that can internationalise the measures in the capital markets union, in an effort to replicate the success of the OECD in the tax field, and the BIS in the prudential. If some jurisdictions are not prepared to work to IOSCO standards, this should not prevent the EU from developing them with other jurisdictions.

• One of the objectives of CMU should be the development and putting into practice of an improved regime for assessing equivalence with partner countries. This needs to be both pragmatic and predictable, providing a coherent approach in the equivalence determination. The regime needs to take account of the different regulatory environments and approaches in partner countries, eschewing a one-size-fits-all approach, and instead providing for flexibility on the basis of agreed principles. Where the Commission deviates from ESMA advice, it should explain its reasoning, and make clear in advance the criteria it will use to make equivalence decisions, thus providing the market with a higher degree of predictability.

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?
Improving the investment chain

Commission’s analysis regarding the single rule book, enforcement and competition includes:

- The single rulebook is a major step forward to enforce EU regulation consistently but the single rulebook’s success depends on consistent implementation and enforcement.
- Supervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
- Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
- Market infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

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

Regulatory reconciliation is a key in the next years.

The Capital Markets Union should ensure that the long-term goal is to reduce the regulatory burden to what is essential. Additionally, loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences.

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?

- Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to “crack-down” on national CAs who go further than what has been envisaged under certain Directives?
- In relation to ESMA, consistent supervision can be enforced with the implementation of its guidelines through peer reviews and consistent application across the 28 Member States.
- ESMA should also prioritise the promotion of unified reporting requirements.

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?

- The overall legal framework for securities varies widely by country. For example, legal barriers make it much more complex to hold securities cross-border, and lead to higher costs for transactions. In addition, they cause difficulties and uncertainty among investors when they exercise their rights abroad.
• Given that legal uncertainty of this nature acts as a barrier to financial stability and growth, the European Commission has been examining barriers within securities markets for several years, with the aim of creating a stable and efficiently functioning single market.

• Continued harmonisation of rules and standards is essential to eliminate costly barriers and reduce complexity for investors and companies. Initiatives in this area, building on the Single Rulebook as a harmonised regulatory framework, should increase the attractiveness and returns on investment, thereby stimulating economic growth.

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?

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?

• Without common applied corporate governance principles/control the Union cannot be done successfully. Thus further harmonisation of national rules and standards are needed in order to eliminate costly barriers and reduce complexity for investors is essential.

• The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and size) company statutory reporting info for the last 12 years is available (for purchase) via the web-site www.allabolag.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

• Language is another impediment.

• Despite significant progress towards the European single market, capital markets are still fragmented with regard to company law, corporate governance rules, creating barriers that hamper the free flow of capital. Those barriers across regions make cross-border investments complex and expensive, and therefore less attractive. The Single Rulebook has not yet been fully achieved.

• Continued harmonisation of national rules and standards in order to eliminate costly barriers and reduce complexity for investors is essential.

• The exercise of cross-border voting rights and the operational complexity of the voting chain is an obstacle to integrated capital markets arising from company law and corporate governance.

• In addition, the concept of differential/enhanced voting rights, introduced in some Member States, could impact cross-border investment flows, one of the key objectives of a Capital Markets Union. It would favour majority shareholders, often domestic entities over minority shareholders, generally cross-border large and individual shareholders.

• A consistent legal framework for creditor protection and insolvency across the EU would also facilitate cross-border investment.
29) What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

Different national insolvency laws make cross-border services expensive. Reducing the existing inefficiencies will play an important role in unleashing the wider macroeconomic benefits from integrating European securities markets.

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?

- Eliminate the double taxation of cross-border dividends and interests within the EU and end tax discriminations against EU investors domiciled in another Member state than the investment provider.
- Review of EU State Aid risk capital guidelines to allow for effective incentive schemes to be adopted by Member States. The guidelines should recognise the role of expansion capital as genuine risk capital. Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Exemption of certain investment rules imposed on certain investors in the case of investments in SMEs (e.g., minimum ratings, liquidity of securities, etc.). This would need to be balanced with any risk of misallocation of capital.

- The Financial Transaction Tax, would increase transaction costs in European financial centres and could therefore impede the goals of the Capital Markets Union. SMEs in particular would face higher capital raising costs as a result of rising transaction costs. Retail investors would also suffer greater financial losses as the tax directly hits retirement provision products. Further, if the financial transaction tax, is introduced in 11 Member States this contradicts the harmonisation intentions within the European Union. However, if introduced, it should not apply to SME transactions. Given that investors in smaller companies usually require a higher rate of return on investment, an additional tax would have a disproportionate increase in the cost of capital for smaller companies and is likely to deter investors from this asset class.

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?

MiFID has posed serious challenges to the bank and broker intermediation chain potentially harming local funding ecosystems.
With regard to Regulated Markets and MTFs, the increased transparency included in regulation such as MiFID represents a challenge for SMEs, resulting in a suboptimal time allocation for SMEs’ board and management and ensuing increased costs of accessing public markets. In addition, MiFID has also heightened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

It is therefore useful to lean from experiences – such as the ELITE programme – that tries to address this issue.

The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the Uk in 2014, where it now counts 33 participants.

Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a “work zone” supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is “capital neutral” to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.

It is made up of different phases:

1° phase - GET READY: It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities.

2° phase - GET FIT: New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support, where appropriate, of a dedicated external advisory team.

3° phase – GET VALUE: Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European ELITE community of advisers, investors and stakeholders.

Elite was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the Uk in 2014, where it now counts 33 participants. In December 2014 Borsa Italiana and the London Stock Exchange Group have presented the imminent launch of a Europe-wide Elite program at the European Parliament; it will be a European platform deeply rooted in each domestic market, through partnerships with local institutions enabling companies to access support and advice throughout Europe.
The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.

- Transaction costs should be lowered towards the US level
- Actual consolidated tape – free for individual investors after a few minutes – should be now eventually enforced in Europe. A debate on the consolidated tape, as included in the data and reporting section, should be addressed within MiFID II. Article 90.2. MiFID II even includes a review clause for the CTP regime. To avoid double regulation, it's strongly recommended to delete the part on consolidated tape.

Please avoid wording “consolidated tape” as this has a different meaning in context of MiFID. Suggest to ask for retail data provided by investment firms that delivers investment services to retail customers to ensure best execution (and verification).

Please add for clarification and to avoid double regulation.
Dear all,
With my apologies for the late sending, please find attached my suggestions and comments incorporated in the document on CMU.
I look forward to our meeting tomorrow.
Kind regards,

Dear Members of the SMSG,
Please find attached the final agenda.
Secondly for agenda point 3 please find the draft CMU paper previously circulated, and including comments made. On behalf of [Name], please note that the inclusion of the various comments in the draft are made solely to reflect the points made by members in order to provide an overview and does not in any way represent what the final paper will look like; that will be discussed at meeting.
Finally for agenda point 8, please find the ESMA consultation paper on complex products and structured deposits.
Kind regards,
ESMA Securities Markets Stakeholder Group

Contribution to the Green Paper “Building a Capital Markets Union” (CMU)

In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises’ (SME) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium sized companies to have access to funding (through private equity and venture capital funds or through capital markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Preliminary comments

In its initial advice, the SMSG stressed that using capital markets bring many advantages to SMEs including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they are able to provide (in light of Basel III, possibly the Volcker Rule, the future structure of banking paper, etc.) that would make it increasingly more difficult to extend loans to SMEs.

In its 2012 report, the SMSG concluded that regulatory initiatives often have a negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that there is a need to focus on how to provide to each category of investors the right incentives to encourage this broad community to invest not only in equity but also in debt issued by smaller companies and how to structure an efficient, transparent and competitive market so that investors can get reliable liquidity in their investments. This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens as individual investors. In addition, the state of development of capital markets, the needs, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed in the EU. It is likewise important that actions focus on the financial sector as a whole and not as a set of silos.

In order to achieve the objectives of the Capital Markets Union, it is essential to develop initiatives to restore investor trust and confidence, in order to revive demand for new sources of funding. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available across Member States.

The Green Paper identifies five priority areas for short term action including the following:

1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;
2. Widening the investor base for SME and improving credit information on SME;

3. Creating a single market in investment services across the EU;
4. Strengthening the role of the National Competent Authorities;
5. Improving access to debt finance.

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3. Building sustainable securitisation;
4. Boosting long-term investment;
5. Developing European private placement schemes

**General comment:**
Unfortunately none of these five priorities for the short term involves individual investors, except – but probably marginally – ELTIFs. However, the Commission itself rightly points out that “households are the main source of funds to finance investment” (Green Paper on the long term financing of the European economy). Therefore, a successful CMU must involve and attract individual investors. “It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors … The protection of investors should play a major role in building the CMU” (Steven Maijoor, Chair of ESMA). Improving investor protection and clarifying choices for consumers must take a prominent place in the CMU initiatives.

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:

**1. The Prospectus regime - lowering barriers to accessing capital markets and the proposals regarding...**

An effective overall funding environment in Europe must seek to:

- Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.
- Attract a wider set of investors to smaller or growing businesses or innovation through financing of “research and development programs” by reducing the regulatory and fiscal burden especially on such investors that invest in SME investors.

The SMSG SME believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no ‘one-size fits all’ solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SMSG SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

- More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.
- Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS) - should be optional for SMEs.
Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.

Pre-IPO registration process - prior to the formal offer of securities – would help issuers take advantage of the relatively short term 'IPO window'. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.

Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and or key adviser. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained.

EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMEs. In its current form, the Prospectus – and in particular the “Summary Prospectus” - is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

3. Securitisation and corporate debt - building debt market financing for SMEs

When exploring the topic of fixed income market financing for SMEs, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an additional definition for the ‘Entreprises de Taille Intermediaire’ which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally.
Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies.

There is another aspect that should be taken into account: small companies (and new initiatives) are more likely to be financed through tranched securitised instruments, whereas medium size companies are in a better position to directly access capital markets. Consequently, to ensure participation of retail investors in the growth of capital markets, the data that must be provided by the issuers must be equally simple and transparent for investors.

- **Refinancing of SME bank loans through securitisation**

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, credit teams for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a show stopper; and the structurally lower visibility of a smaller business a real difficulty.

It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond – bearing however the limits of their embedded derivatives) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as of end 2012 the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIF report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.

- **Corporate bond markets**
There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. There are three notable initiatives in Europe of this nature: the Initial Bond Offering launched by NYSE Euronext in 2012, modelled on equity IPOs; the German Bond M market create by the Stuttgart Stock Exchange in 2010; and the LSE ORB market launched in February 2010.

The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of these mixed results.

There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly though the desired expansion of securitisation to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channelling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity [markets].

4. Boosting Long-term Investments

In its 2012 advice, the SMSG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities as well as to private equity and venture capital funds. If pension funds covered by IORPD5 would also have to comply with Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds’ ability to invest into equity and other long-term assets, but may over time lead to companies being faced with increased costs for pension benefits, as pension funds find it difficult to generate the necessary long-term returns to match their long-term liabilities.

Given the plethora of investment funds in Europe (33000 versus 8000 in the US which is a more than twice bigger market), it will be difficult to justify the addition of yet further additional categories of long term funds such as European Long Term Investment Funds (ELTIFs), European Venture Capital (EuVECA) and European Social Entrepreneurship Funds (EuSEF), and of a Pan-European personal pension plan (“29th regime”) on the EU market, unless the industry and/or the regulators start streamlining, standardising and simplifying the other long term funds and individual investment product offerings. For example,
in France alone, there are already nine long-term AIFs legal categories, most of which are marketed to individual investors, all with special tax provisions.

5. Developing a European Private Placement scheme

For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldschein) providing approximately €15 billion of debt in 2013.

These markets provide financing through the use of so-called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets. This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be “privately placed” to individual or small groups of institutional investors as in the case for example of reverse enquiry EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the European Private Placement Association (EU PPA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements.

Most recently the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:

- Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.

1. FCPR, FCPI, FCPE, FEP, OPCI, SICAF, SICAVAS, SCPI, SPPICAV
The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.

Detailed response to the Commission's Green Paper

Improving SME access to finance:

The Green Paper's analysis:
- for SMEs: diversity and scant credit information, preference to relationship based lending (hence banks);
- for start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring
- for mid-caps: access to public markets is costly
- Corporate bond markets lack transparency and standardisation
Crowdfunding remains focused on national markets

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

In the context of the publication of the SMSG own initiative report published in 2012, the Group advised the following additional measures:

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME's access to finance and investor's ability to invest.
- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them.
- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.
- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital and other early stage fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.
- Creation of public support specific to these companies (for example, subsidized credit lines).
- Commissioning a comparative review of the EU and US high yield debt markets with a specific focus on providing investors access to smaller companies at mutually attractive terms.
- Developing a flexible EU "bankruptcy regime" (similar to the Chapter 11 provisions in the US).

In addition the following tax incentives could be considered: If start-ups were allowed to off-set social charges against their tax-loss carry forwards which they typically accumulate during their early years of existence rather than eventually selling them off to a more mature company (who will use them to off-set tax on corporate profits), this would help reduce their overall funding needs in the beginning while allowing them to employ staff during critical growth stages of their development.

- Revive individual investors' involvement in equity markets: in 1970 individual investors held directly close to 40 % of EU listed companies, compared to about 13 % today.
- Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment products by standardising, simplifying, streamlining and reducing the cost of - pack-aged investment products.

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?

When SMEs decide to use rating agencies, incentives, also for corporate debt rating, could be considered as follows:

- Reducing information asymmetries between issuers and investors and, as such, the risk premium demanded on loans to SMEs.
- Protecting investors, through the provision of additional information about the additional risks they are incurring with these types of investments.
- Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by recognized External Credit Assessment Institution (ECAI).
- Reducing costs by making the assets accepted as collateral in liquidity-providing operations to banks by the ECB, if the ratings are issued by recognized ECAI.

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

The SMSG needs to develop this section as no prior advice is available.

There should be two separate types of ELTIFs, those catering for the needs of institutional investors and those catering for the needs of retail investors. If all ELTIFs are modelled on the needs of retail investors (liquidity, investor protection, etc.) it risks making them unnecessarily expensive for the institutional investors.

At the same time a single set of rules for all types of investors (retail, or professional; small, medium, or large) will fail to recognize different needs of such a wide range of investors or of a wide range of eligible assets. ELTIFs seek to attract. Therefore, the possibility to adapt the structure on the different needs of the investors’ base of each ELTIF is necessary to increase their market attractiveness and finally their success in financing of the long-term needs for growth of the EU economy.

The discretion of the asset manager to choose whether to open the ELTIF to retail investors or not along with the discretion as to the portfolio composition and the early redemption rights are welcome. Still, additional effort should be made to attract particular categories of investors such as:

- Small pension plans and local associations that have the capacity (or are sometimes even required) to lock up some of their capital for a period and to diversify their portfolio beyond cash and high liquid securities. As those investors are classified as retail investors they will be excluded from a number of ELTIFs open only to professional investors, whereas the request to be treated as professional investors based on the MiFID criteria is not relevant to them as it might generate too high a legal hurdle and important costs for them.
- Insurance companies who again wish to further diversify their portfolios, but investment on long-term illiquid assets such as infrastructure or non-listed SMEs are “penalised” as to the important capital requirements they bring.
Moreover additional flexibility when it comes to the lifetime of the ELTIF in order to make it possible to adapt to the changes in the long-term landscape of its investment strategy, would make it feasible for ELTIFs to take advantage of market opportunities to the benefit of their investors.

Apart from the need to deliver a regulatory framework of ELTIFs able to meet their investors’ needs, it should be stressed that their market potential will be linked to a great extent to the general regulatory environment. Ensuring that substantial incentives are in place includes also the provision of tax incentives and the removal of any fiscal or administrative barriers. Moreover, investors need and seek stable and predictable regulatory environments. This prerequisite becomes even more relevant in the case of illiquid investments, in which the link to a particular jurisdiction is of longer duration. Finally, education on financial principles and tools for retail investors will help them understand the risks associated with the financing of a long term project and the economic and social benefits.

Any successful development of ELTIFs should consider:

Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFs have the potential to play an important role in capital market funding in the EU, if the right incentives for investors are there. Moreover, because ELTIFs are intended to invest in illiquid, often private (as opposed to public) assets, ELTIFs may need to operate only nationally if at all, given the various national restrictions on banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFs, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

- the inability of funds to originate loans;
- the need for a banking licence to originate loans;
- bank liabilities preferred on bankruptcy;
- the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
- restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
- different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

The SMSG needs to develop this section as no prior advice is available.

EU could undertake a review of the current obstacles to cross-border fundraising which have eg arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.
In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Corporate Private Placement Market Guide published on 11 February 2015), we suggest that a revision of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation (EU) 2015/35) should be considered. Although the final calibrations in the Delegated Act (the “long term guarantees package”) has helped remove obstacles to investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investment in private placements, as well as more generally in long-term assets.

Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

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

The SMSG needs to develop this section as no prior advice is available.

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, eg rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.

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?

The SMSG needs to develop this section as no prior advice is available.

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets. It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bond markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be incon-
sistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues from the rest of the sector could come to resemble the more bespoke private placement market, on the other hand.

Consequently, it might be advisable to start with the standardisation of loans before developing standards on securitisation. Securitisation of SME would be better handled if loans are more accessible to investors, especially institutional investors.

The second step (or alternative approach to complete standardisation) should be to encourage standardisation of the criteria to monitor rather than the values to have access to capital markets.

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

The SMSG needs to develop this section as no prior advice is available.

As a preliminary comment, it is important to note that green bonds like any other listed bond come under the scope of existing financial regulation both at the EU and national levels. Green bonds are therefore not being issued in any form of regulatory void. They also benefit from a successful self-regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process represented by the GBP is preferable to a top-down normative approach leading for example to a green bond "label" formally recognized at a regulatory level. This would risk creating unnecessary market segmentation, as well as the perception of potential liabilities for issuers that could dissuade them from entering the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond market as they both experience additional costs compared to mainstream alternatives, and/or in order to maintain or accelerate the development of the market in support of wider public policy objectives related especially to the fight against climate change. The GBP require additional work from green bond issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g. dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green bonds and the underlying environmental projects. These costs are not reflected in the economics of green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal identified above of avoiding a top down normative approach to these securities.
At this stage, it is therefore most likely preferable to allow the green bond market to continue its development based on its current strong momentum and successful self-regulation (within the safeguards provided by mainstream financial regulation). An active dialogue can be maintained on the need for possible future incentives between the Commission and national authorities on the one hand, and industry associations and self-regulatory initiatives on the other.

It is not necessary for the EU to take any legislative action for the development of Environment, Social and Governance ‘ESG’ investment. Numerous recent pieces of legislation introduce ESG disclosure requirements, such as country-by-country reporting, Revision of the Shareholders’ Rights Directive, efforts on conflict minerals, transparency requirements in the UCITS KIID and PRIIPs KID. The impact of these pieces of legislation now needs to be reviewed. However, the European Commission could play a role in the promotion of ESG. Finally, given the evolving nature of the industry, standardisation of processes should not be discussed at this point of time as market driven initiatives need to be given the space to grow.

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

The ESMA SMSG is in favour of the distinct and separate SME market regime under MiFID II and MAD

The SMSG believe that such a regime would have the following benefits:
- recognise the role such markets currently play in the EU funding environment;
- ensure that changes to EU financial services regulation do not adversely impact small caps;
- cater for a secondary market for trading shares of less liquid SMEs;
- allow for further development of regulatory and fiscal EU policies to attract investors to this asset class.

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 one of the emerging financing models that contribute to helping start-ups move up the “funding escalator”, as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refers to open calls to the wider public to raise funds for a specific project. These calls are often published and promoted through the internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used
taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds.

- Non financial crowdfunding, includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- Financial crowdfunding, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, Understanding Alternative Finance, Peter Baeck, Liam Collins, Bryan Zhang, November 2014) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.

Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects raise funds are themselves also relatively small business. According to the same Nesta report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200,000 pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no previous investment experience. Estimation of activity for the European Union is not easy, and overall figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax reliefs to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, rising awareness, etc.) addressed at promoting its usage as a financing vehicle. ESMA recently published an Advice on Crowdfunding to European Parliament, Council, and Commission taking into account the need of promotion and clarification, while at the same time preserving investor protection at its highest level.


The main objective of the report is to assist NCA’s and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.
Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is pure reception and transmission of orders, in which case a 50,000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission’s programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU-based platforms that could compete with the US ones.

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?

ESMA SMSG insists on the need to avoid regulatory barriers to fluid markets such as FTT.

Regulatory convergence is also very important.

As developed in our reply to the Question 9, we believe that this should be harmonised in the EU-US trade relationships.

Supply side: institutional investors

The Green Paper’s analysis of current regulation and tools

**UCITS V and AIFMD**
- The directives are still insufficient to reduce cost and diversify managed funds investment.

**On pensions and insurance:**
- There could be a review of Solvency II (and CRR) delegated acts, to adapt prudential rules for identified sub-classed of lower-risk infrastructure investment.
- The Commission asks which sub-classes should be prioritised for.

**On professional pensions:**
- Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

Private equity and venture capital:
• EuVECA and EuSEF Regulations - the clause impedes managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
• Commission asks which measures could be proposed to: increase scale of venture capital funds (both via public and private contributions, improve exit strategies and supply for investors and boost supply of venture capital to start-ups.

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as these funds are typically closed-ended and unleveraged; if not - the € 100 m threshold would apply ) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. However, the potential to be caught by AIFMD will [deter] funds from gaining scale which is ultimately needed to allow a fund to diversify and achieve attractive returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds >€100m compared to 227 in the US3. The SMSG is aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequences in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive.'

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU countries there are still institutional barriers to larger investments by eg pension funds, insurance funds etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so called prudent person rules.

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?

Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given the lower liquidity of the underlying assets.

3 Earlybird Europe Venture Capital Report – July 2011
There are 33,000 funds in the EU versus 800 in the US. The average size of an EU fund is about €200 million versus €1,600 million in the US, i.e., 8 times bigger. The annual fees of EU equity funds are 170 bps (2011: last available info) versus 74 bps in the US (2013).

The number of funds must be drastically reduced, especially AIFs as they are more numerous (about 20,000), smaller and often only distributed on a national basis. For example, Better Finance is proposing to ban AIFs in retail packaged products such as unit-linked insurance contracts and pension plans, in favour of UCITS.

For individual EU investors the problem is compounded by the fact that direct fund holdings account for only 7% of their financial assets; most economic retail ownership of funds is through wrappers that add yet another layer of costs further reducing the net returns to EU citizens.

Review of the tightening of the national private placement regimes for cross-border marketing of especially below threshold funds that followed as a result of the implementation of the AIFMD. Review of the practice of many national CAs to impose additional charges and/or additional conditions (like a French paying agent) for managers who have already been granted the EU passport in their home jurisdiction.

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?

EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any future proposals to introduce similar regulation for pension funds must not place conditions that adversely impact the ability to directly or indirectly invest in small caps. The capital and liquidity requirements under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest and most liquid blue-chip equities or even only interest bearing instruments like government bonds due to the lower risk weightings for these than equities in general and deter any existing appetite for smaller companies. An appropriate exemption for direct or indirect investment in small cap securities should be implemented.

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

Yes

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?

The European Venture Capital Funds Regulation (EVCFR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes...
holdings in SME markets as 'qualifying portfolio companies'. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest Institutions do) nor have necessarily worked in the financial industry.

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 SMSG needs to develop this section as no prior advice is available.

As mentioned above through not imposing overly restrictive capital requirement, not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class. Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor.

Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company’s development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the “valley of death”.

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

The SMSG needs to develop this section as no prior advice is available.
Supply side – retail investors

- Commission asks how to increase participation in UCITS by cross-border retail;
- Share best national best practices in the development of simple and transparent investment products for consumers;
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

17) How can cross border retail participation in UCITS be increased?
Review of UCITS directive to identify ways to attract dedicated UCIT funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the advantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make investments directly in SME issuers.

UCITS are much more cross-border than AIFs already because the two major domiciles for UCITS are largely “off-shore”: Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross-border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).

18) How can the ESAs further contribute to ensuring consumer and investor protection?
The SMSG needs to develop this section possibly based on prior advice if available.

ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better enforce existing investor protection rules.

For all this they need their resources to grow, not to be cut.

Each ESA should be given the necessary resources to build a Single Rulebook for the sector it supervises. A level playing field for financial products services regulated by the three ESAs is essential for ensuring consumer and investor protection.

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

These already exist, at least in Sweden, and at least when it comes to listed SMEs as well as listed SME bonds.

This regards only SMEs. In addition ELTIFs have been precisely set up to fund SMEs (and also infrastructure projects). Individual investors already suffer from the proliferation and complexity of funds offerings in Europe. The last thing they need is yet another category on top. There are already UCITS funds dedicated to SME investing.
The savings rate of household is already quite high in Europe. Also, contrary to what one often reads, individual investors are not more short termist nor more risk averse than other investors:

- 62% of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80% of their total savings are long term if property is taken into account.
- DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least).
- By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8% from 2001 to 2010: way before Solvency II.
- The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.
- The involvement of individual investors in SME markets is about twice as large as it is in blue chips.
- What individual investors do not like is high risk – low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the first category returned a net real after tax return of 20% since 2000, the latter a negative one of minus 14% over the same period.

Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax offsetting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.

Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected they will be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders’ voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.
• Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.

• Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.

One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax deductible expenses for a company and then taxed in the hands of the recipient, dividends are subject to double taxation (made out of taxed corporate profits and then taxed again in the hands of investors).

20) Are there national best practices in the development of simple and transparent investment products for consumers which can be shared? The SMSG needs to develop this section possibly based on prior advice if available.

To our knowledge, the longer term the retail investment products are the more complex. This is why a simple, standardized Pan-European personal pension plan is needed.

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? The SMSG needs to develop this section possibly based on prior advice if available.

Yes:
- The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further standardise and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance Mediation and IORP Directives should be amended in order to make their summary documents more standardised, simpler, shorter, in Plain English and more comparable between each other and with other investment products.
- IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.
Supply side – non-EU investment

Attracting non-EU investment:
- The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
- The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

The SMSG needs to develop this section possibly based on prior advice if available.

EU needs to continue to ensure “reciprocity”, ie not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market internationally.

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?

The SMSG needs to develop this section possibly based on prior advice if available.
Improving the investment chain

Commission’s analysis regarding the single rule book, enforcement and competition includes:

- The single rulebook is a major step forward to enforce EU regulation consistently but the single rulebook’s success depends on consistent implementation and enforcement.
- Supervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
- Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
- Market infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

24) In your view, are there areas where the single rulebook remains insufficiently developed?
The SMSG needs to develop this section possibly based on prior advice if available.

25) Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a capital markets union?
The SMSG needs to develop this section possibly based on prior advice if available.

Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to “crack-down” on national CAs who go further than what has been envisaged under certain Directives?

In relation to ESMA, consistent supervision can be enforced with the implementation of its guidelines through peer reviews and consistent application across the 28 Member States.

ESMA should also prioritise the promotion of unified reporting requirements.

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?
The SMSG needs to develop this section possibly based on prior advice if available.

27) What measures could be taken to improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?
The SMSG needs to develop this section possibly based on prior advice if available.

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 SMSG needs to develop this section possibly based on prior advice if available.

The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and size) company statutory reporting info
is available (for purchase) via the web-site www.allabolag.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

Language is another impediment.

The exercise of cross-border voting rights and the operational complexity of the voting chain is an obstacle to integrated capital markets arising from company law and corporate governance.

In addition, the concept of differential/enhanced voting rights, introduced in some Member States, could impact cross-border investment flows, one of the key objectives of a Capital Markets Union. It would favour majority shareholders, often domestic entities over minority shareholders, generally cross-border large and individual shareholders.

A consistent legal framework for creditor protection and insolvency across the EU would also facilitate cross-border investment.

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

The SMSG needs to develop this section possibly based on prior advice if available.

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?

- Eliminate the double taxation of cross-border dividends and interests within the EU and end tax discriminations against EU investors domiciled in another Member state than the investment provider.

- Review of EU State Aid risk capital guidelines to allow for effective incentive schemes to be adopted by Member States. The guidelines should recognise the role of expansion capital as genuine risk capital. Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Exemption of certain investment rules imposed on certain investors in the case of investments in SMEs (e.g., minimum ratings, liquidity of securities, etc.). This would need to be balanced with any risk of misallocation of capital.

- The Financial Transaction Tax, if introduced, should not apply to SME transactions. Given that investors in smaller companies usually require a higher rate of return on investment, an additional tax would have a disproportionate increase in the cost of capital for smaller companies and is likely to deter investors from this asset class.
The SMSG needs to develop this section possibly based on prior advice if available.

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?

**MIFID has posed serious challenges to the bank and broker intermediation chain potentially harming local funding ecosystems**

With regard to Regulated Markets and MTFs, the increased transparency included in regulation such as MiFID represents a challenge for SMEs, resulting in a suboptimal time allocation for SMEs’ board and management and ensuing increased costs of accessing public markets. In addition, MiFID has also heightened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

**The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain.** At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the UK in 2014, where it now counts 33 participants.

Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a “work zone” supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is “capital neutral” to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.

It is made up of different phases:

- **1° phase - GET READY:** It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities.
- **2° phase - GET FIT:** New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support, where appropriate, of a dedicated external advisory team.
- **3° phase – GET VALUE:** Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European ELITE community of advisers, investors and stakeholders.

In December 2014 Borsa Italiana and the London Stock Exchange Group have presented the imminent launch of a Europe-wide Elite program at the European Parliament; it will be a European platform deeply.
rooted in each domestic market, through partnerships with local institutions enabling companies to access support and advice throughout Europe.

- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxyers from their members.
- Transaction costs should be lowered towards the US level
- Actual consolidated tape – free for individual investors after a few minutes – should be now eventually enforced in Europe.
Dear [Redacted]

Please find attached some further comments on the CMU paper for consideration. Apologies for the late input. I look forwarding to seeing you all in Paris.

Many thanks
[Redacted]

(See attached file: 20150413_SMSG Comments on Text.doc)
Dear Members of the SMSG,

Please find attached the final agenda.

Secondly for agenda point 3 please find the draft CMU paper previously circulated, and including comments made. On behalf of [redacted], please note that the inclusion of the various comments in the draft are made solely to reflect the points made by members in order to provide an overview and does not in any way represent what the final paper will look like; that will be discussed at meeting.

Finally for agenda point 8, please find the ESMA consultation paper on complex products and structured deposits.

Kind regards,

[Redacted]
ESMA Securities Markets Stakeholder Group

Contribution to the Green Paper “Building a Capital Markets Union” (CMU)

In October 2012, the Securities Markets Stakeholder Group (SMSG) presented its views on the impact of regulation on Small and Medium Size Enterprises’ (SME) ability to access funding. The objective of the group was to give advice on how EU regulatory proposals impact the ability of small and medium sized companies to have access to funding (through private equity and venture capital funds or through capital markets by listing on an exchange) and how EU regulatory proposals impact investors’ ability to invest in these companies. The advice of the group was targeted at ESMA but might also be relevant for other European Supervisory Authorities (ESAs). This paper is a contribution from the SMSG to the current discussion on the CMU and is partly based on the initial advice of the group.

Preliminary comments

In its initial advice, the SMSG stressed that using capital markets bring many advantages to SMEs including the diversification of potential investors and the access to additional equity capital. The Group rightly feared that banks would be facing additional restrictions in the amounts of credit and liquidity they are able to provide (in light of Basel III, possibly the Volcker Rule, the future structure of banking paper etc.) that would make it increasingly more difficult to extend loans to SMEs. The development of the Capital Markets Union may promote alternative funding sources (both equity and debt), to facilitate growth. There is not just one method through which to increase access to funding for SMEs: Fostering a stable, positive environment and incentivising companies through attractive and divers funding options is essential. In its 2012 report, the SMSG concluded that regulatory initiatives often have a negative impact on the ability of SMEs to access funding. It had singled out a number of problems including both the access of companies to capital markets as well as the difficulties for investors to invest into SMEs. The SMSG welcomes the fact that the Commission’s Green Paper shares our analysis and has taken the same approach.

The Group agrees that there is a need to focus on how to provide to each category of investors the right incentives to encourage them to invest not only in equity but also in debt issued by smaller companies and how to structure an efficient, transparent and competitive market so that investors can get reliable liquidity in their investments. This needs to be complemented by measures that enable individual retail investors to invest more directly into capital markets as an effective capital markets union will not function without involving and attracting EU citizens as individual investors. In addition, the state of development of capital markets, the needs, and the cultures vary significantly across Member States which has to be taken into account, regardless of any action to be initiated by the Commission. It is obvious that these differences place strong limits on how far an integration of capital markets can proceed in the EU. It is likewise important that actions focus on the financial sector as a whole and widen and deepen European capital markets, across not only the euro countries, as in the Banking Union, but across all 28 EU Member States. In order to achieve the objectives of the Capital Markets Union, it is essential to develop initiatives to restore investor trust and confidence, in order to revive demand for new sources of funding. Only well-educated, well-informed and well-protected investors can and will make responsible investment decisions from the range of capital markets products available across Member States.
The Green Paper identifies five priority areas for short term action including the following:

1. Lowering barriers to accessing capital markets and reviewing the prospectus regime;
2. Widening the investor base for SME and improving credit information on SME;
3. Building sustainable securitisation;
4. Boosting long-term investment;
5. Developing European private placement schemes

General comment:
Unfortunately none of these five priorities for the short term involves individual investors, except – but probably marginally – ELTIFs. However, the Commission itself rightly points out that “households are the main source of funds to finance investment” [Green Paper on the long term financing of the European economy]. Therefore, a successful CMU must involve and attract individual investors. “It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors . . . The protection of investors should play a major role in building the CMU” (Steven Maijoor, Chair of ESMA). Improving investor protection and clarifying choices for consumers must take a prominent place in the CMU initiatives.

Regarding these five short-term priorities identified by the Commission, the ESMA SMSG would like to stress the following:

1. The Prospectus regime - lowering barriers to accessing capital markets and the proposals regarding

An effective overall funding environment in Europe must seek to:

- Ensure an appropriate regulatory framework for issuers that does not prove overly burdensome for them whilst still ensuring investor confidence.
- Attract a wider set of investors to smaller, growing businesses by reducing the regulatory and fiscal burden on such SME investors.

The SMSG SME believes that EU policy makers can contribute to these objectives through EU legislation in several ways and that there is no ‘one-size fits all’ solution. The ESMA SMSG believes that it is important to make it easier for companies to access capital markets. That said, the SMEG SME working group is not in favour of a reduction of disclosure requirements as such for SMEs under the Prospectus Directive. It rather believes that access can be made easier also through addressing the following:

- More flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short. This is more harmful to SMEs because of the relatively high fees.
- Costs - such as those incurred by the application of International Financial Reporting Standards (IFRS) - should be optional for SMEs.
- Going forward, the EU legislation should seek to reduce the additional costs of translation. Today, many exchanges request the publication of the full prospectus in the national language even if an English version is available.

- Pre-IPO registration process - prior to the formal offer of securities – would help issuers take advantage of the relatively short term ‘IPO window’. This could be encouraged through the existing PD framework which allows publication of a Registration Document prior to an offer of securities which would be supported by a Securities Note.

- Alternatively, the review of Prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and or key adviser. This would help lower the cost of capital for smaller companies while ensuring the existing framework for Regulated Markets is maintained.

- EU initiatives should seek to enhance the value of the Prospectus for investors while reducing burdens for SMES. In its current form, the Prospectus – and in particular the “Summary Prospectus” - is not used by investors as it is written in legal jargon, from lawyers for lawyers, and therefore serves rather as an instrument to release out of liability. Value-enhancing measures should therefore include a requirement for an adequate readability of the Prospectus accompanied by the introduction of a risk-weighting model that shows (potential) investors the probability of risk occurrence and the risk impact.

2. SME credit scoring - widening the investor base

Research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Provisions should be implemented to make existing research and ratings information available to a wider set of potential investors and thus help reduce information asymmetries associated with smaller companies. In some countries (i.e. UK, Canada and South Korea) the SME market is sustained by a market maker model based on spreads. Other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

3. Securitisation and corporate debt - building debt market financing for SMES

When exploring the topic of fixed income market financing for SMES, it is important to distinguish between small and medium companies. The official EU definition is very broad and covers a range going from small corner shops to medium sized companies. The French Authorities have introduced an additional definition for the 'Entreprises de Taille Intermediaire' which covers medium-sized companies and is very helpful in the context of this discussion.

It is also necessary to acknowledge the different roles played by bank, private placement and fixed income markets in financing small and medium sized companies in Europe as well as internationally.
Taking this into account, it is possible to focus on the potential refinancing role of bank finance for both small & medium sized companies that bond markets can play through securitisation; and the direct financing opportunity that bond and private placement markets can provide for medium-sized companies. Further, in the context of the creation of new securities (e.g. private placements), the use of market infrastructures should be promoted, as they increase stability, by using safe, stable and reliable electronic systems, allowing e.g. for notary functions and reconciliation measures (i.e. ensuring integrity of the issue). Services provided by market infrastructures further facilitate an extensive international investors' reach, not only domestic investors are reached, but also investors on a European and global level may be reached. This reduces the 'home-bias' phenomenon.

- Refinancing of SME bank loans through securitisation

Bond markets are poorly configured for the direct financing of small companies in comparison to retail banks. Banks have both flexible and standardised working capital and asset finance loan products, as well as local branch networks, credit teams for small corporates, regular contact with management and daily knowledge of cash flows. Conversely, the relative overall costs involved (including legal and due diligence) of a bond issue for smaller amounts can be uneconomic compared to the amount being financed. Similarly, the reporting requirements and administrative burden of a bond may be disproportionate for a small transaction. For investors, the size and irregularity of potential issuances of SMEs are also typically unappealing; the frequent absence of a credit rating can be a show stopper; and the structurally lower visibility of a smaller business a real difficulty.

It has been argued, including by the official sector (see 2014 ECB speech), that bond markets can play an important role in refinancing SME bank loans through securitisation (and covered bond) structures. This would be facilitated by the rehabilitation of securitisation post 2008 given progress on bank risk sharing and transparency (for example through the ECB’s Loan Level Initiative.) Although this is correct in principle, the fact that pre-2008 SME loan securitisation was very limited in a securitisation market dominated by mortgage and consumer finance loans is often overlooked (see 2014 OECD Non-bank debt financing for SMEs).

Furthermore, there is often confusion between actual market based SME securitisation and Central Bank refinancing of such securitisations. Indeed the eligibility of SME loans as collateral for the LTRO and other credit operations of the ECB has created an important outlet for these assets. As a result as of end 2012 the ECB held €35 billion of SME related collateral. It is hoped that fixed income markets will progressively accommodate these transactions, but in practice SME securitisation appears very dependent on official sector credit enhancement mechanisms to make that transition away from Central Bank refinancing (see 2013 EIB report).

An important market initiative supports the post crisis rehabilitation of the use of asset backed securities and securitisation in the form of Prime Collateralised Securities (PCS). The PCS label aims to “enhance and promote quality, transparency, simplicity and standardisation throughout the asset-backed market”. Pooling and standardisation of loans is needed to ensure transparency and comparability. It is also designed to help stretch the reach of securitisation to SME loans beyond its past widespread application to mortgages and consumer lending, but in practice this has not yet occurred.

- Corporate bond markets

There have been a number of market driven efforts to open up bond markets directly to smaller companies drawing on what has been done in the equity markets and also generally targeting retail investors. There are three notable initiatives in Europe of this nature: the Initial Bond Offering launched by NYSE
Euronext in 2012, modelled on equity IPOs; the German Bond M market create by the Stuttgart Stock Exchange in 2010; and the LSE ORB market launched in February 2010.

The results of these initiatives have however been modest with respect to amounts raised, and have also generated concerns for supervisory authorities especially with respect to the involvement of retail investors and their ability to realistically assess the implied credit risks. A recent report commissioned by the CityUK provides a highly informative summary of these mixed results.

There have also been initiatives to develop placements of debt securities for SMEs through shared SPVs (e.g. in France, the Micado France 2018 vehicle). These have however not been replicated on any significant scale.

In conclusion, debt capital markets can play a substantially greater role going forward in financing SMEs and medium sized corporates in Europe. This role can play out indirectly though the desired expansion of securitisation to SME loans to refinance banks. Its progress remains however highly dependent on central bank and official sector credit enhancement. The channelling of market finance, aimed at medium sized rather than small companies, can also happen directly through ongoing new initiatives - with the most recent and tangible being perhaps the ongoing drive to establish a pan-European Private Placement Market.

As far as the global corporate bond markets are concerned, they should become more attractive to individual investors, especially at a time of very low interest rates where retail bond funds will face a bigger challenge to offset fees to deliver a positive real return to investors. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

4. Boosting Long-term Investments

In its 2012 advice, the SMSG had stressed that the implementation of CRD III and Solvency II have already generated a decrease in investment flows from banks and insurance companies into equities as well as to private equity and venture capital funds. If pension funds covered by IORPDS would also have to comply with Solvency II type of risk weightings, they will be required to hold additional liquid assets. This would not only have a negative impact on pension funds' ability to invest into equity and other long-term assets, but may over time lead to companies being faced with increased costs for pension benefits, as pension funds find it difficult to generate the necessary long-term returns to match their long-term liabilities.

Given the plethora of investment funds in Europe (33000 versus 8000 in the US which is a more than twice bigger market), it will be difficult to justify the addition of yet further additional categories of long term funds such as European Long Term Investment Funds (ELTIFs), European Venture Capital (EuVECA) and European Social Entrepreneurship Funds (EuSEF), and of a Pan-European personal pension plan (“29th regime”) on the EU market, unless the industry and/or the regulators start streamlining, standardising and simplifying the other long term funds and individual investment product offerings. For example,
in France alone, there are already nine long-term AIFs legal categories, most of which are marketed to individual investors, all with special tax provisions.

5. Developing a European Private Placement scheme

For many years, mid-sized European companies have accessed the US Private Placement (USPP) market, making up a significant proportion of its nearly $50 billion of annual issuance. In 2013, European companies raised $15.3bn in this US market. In Europe itself, the popularity of private placements has accelerated since the onset of the financial crisis, with French and German domestic private placement markets (i.e. respectively the Euro PP and Schuldbschein) providing approximately €15 billion of debt in 2013.

These markets provide financing through the use of so-called private placements, here defined as private issuance of medium to long term senior debt obligations (in bond or loan format), typically at fixed rate, by companies to a small group of investors. Private placements particularly benefit medium-sized and unrated companies by providing access to long-term debt finance which may not otherwise be available to them from the loan or bond markets. This should not to be confused with other forms of debt market financing that have other characteristics and/or target issuers, but that may also be “privately placed” to individual or small groups of institutional investors as in the case for example of reverse EMTN transactions.

However, until now, there has been no pan-European private placement market. To address this, the International Capital Market Association (ICMA) has taken the lead in coordinating the work of the Pan-European Private Placement Working Group (PEPP WG) that currently includes, alongside major investors and other key market participants, the Association for Financial Markets in Europe (AFME), the Association of British Insurers (ABI), the European Private Placement Association (EUPPA), the French Euro Private Placement (Euro PP) Working Group and the Loan Market Association (LMA). There is also direct official sector participation with notably HM Treasury and the French Trésor, and the Bank of France.

This effort has gathered considerable support at the European level with the EU’s Economic and Financial Affairs Council welcoming in a December 2014 press release such market-led efforts to develop a pan-European private placement market. It has also generated tangible results with the ongoing release of standardised transaction documentation. HM Treasury has also made a declaration contained in the 2014 Autumn Statement indicating that the UK would implement an exemption for withholding taxes for private placements. Most recently, the PEPP WG has met key milestones in promoting the development of a pan-European private placement market with the publication of the following:

- Standardised documentation made available in January 2015 by both the Loan Market Association (LMA) and the French Euro PP WG (developed by the Euro PP Working Group, a French financial industry initiative). This documentation is designed to be complementary, and targeted at different market participants. It is now in use in market transactions.

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1. FCPR, FCPI, FCPE, FEP, OPCI, SICAF, SICAVAS, SCPL, SPIPCAV
The Pan-European Corporate Private Placement Market Guide was released on 11 February 2015. It sets out a voluntary framework for common market standards and best practices which are essential for the development of the market.

In this context it must also be noted that the implementation of the AIFMD has in many member states implied a de facto tightening of the rules governing private placements of below threshold funds (whether EU or non-EU) to European institutional, semi-professional as well as private investors. This has made cross-border marketing of e.g. venture capital and private equity funds more difficult, in turn affecting the overall funding available for investment into SMEs.

Detailed response to the Commission’s Green Paper

Improving SME access to finance:

The Green Paper’s analysis:
- For SMEs: diversity and scant credit information, preference to relationship based lending (hence banks);
- For start ups: there is a lack of tangible assets to be used as collaterals for bank finance, leasing and factoring;
- For mid-caps: access to public markets is costly;
- Corporate bond markets lack transparency and standardisation.
Crowdfunding remains focused on national markets

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

- Improved EU coordination: When considering new policy initiatives, the European Commission should apply a cross-directorate approach and consider how policy as well as other initiatives impact SME’s access to finance and investor’s ability to invest.

- "Regulatory reconciliation": is a key in the next years. Loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences. Surplus or misdirected regulation raises costs for businesses, utilising valuable funds that could instead be turned towards innovation and growth creation. The previous European Commission launched important regulatory initiatives (e.g. CRD IV/CRR, MiFID II/MiFIR, EMIR, CSDR, AIFMD, UCITS V etc.) that should be integrated under the umbrella of the Capital Markets Union. Many important topics are addressed but need to be implemented and brought to life. In light of this, the Capital Markets Union should build on existing regulatory elements and ensure that these are fully implemented. Further, regulators and supervisors should see how existing and recently implemented regulation works in practice, understand the impacts and ensure any overlaps or misinterpretations are addressed, clearly defining the gaps and any market failures, before looking into creation of new regulation. Legal certainty is an important prerequisite for companies.

- Education of SMEs: There is a continuing need to increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them.

- Research and ratings on SMEs: EU legislation should include incentives to foster independent research and ratings of SMEs.

- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital and other early stage fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

- Creation of public support specific to these companies (for example, subsidized credit lines).

- Commissioning a comparative review of the EU and US high yield debt markets with a specific focus on providing investors access to smaller companies at mutually attractive terms.

- Developing a flexible EU “bankruptcy regime” (similar to the Chapter 11 provisions in the US). Further harmonisation/standardisation/removal of barriers.

- In addition the following tax incentives could be considered: if start-ups were allowed to off-set social charges against their tax-loss carry forwards which they typically accumulate during their early years of existence rather than eventually selling them off to a more mature company.

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(who will use them to off-set tax on corporate profits), this would help reduce their overall funding needs in the beginning while allowing them to employ staff during critical growth stages of their development.

- Revive individual investors’ involvement in equity markets: in 1970 individual investors held directly close to 40% of EU listed companies, compared to about 13% today.
- Regain the trust of individual investors and consumers in the intermediated (“packaged”) investment products by standardising, simplifying, streamlining and reducing the cost of - packaged investment products.

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?

When SMEs decide to use rating agencies, incentives, also for corporate debt rating, could be considered as follows:

- Reducing information asymmetries between issuers and investors and, as such, the risk premium demanded on loans to SMEs.
- Protecting investors, through the provision of additional information about the additional risks they are incurring with these types of investments.
- Reducing costs by allowing reduced capital requirements of credit institutions if ratings are issued by recognized External Credit Assessment Institution (ECAI).
- Reducing costs by making the assets accepted as collateral in liquidity-providing operations to banks by the ECB, if the ratings are issued by recognized ECAI.

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

The SMSG needs to develop this section as no prior advice is available.

There should be two separate types of ELTIFs, those catering for the needs of institutional investors and those catering for the needs of retail investors. If all ELTIFs are modelled on the needs of retail investors (liquidity; investor protection etc) it risks making them unnecessarily expensive for the institutional investors.

Any successful development of ELTIFs should consider:

- eliminating the plethora of already existing long term fund categories which are nationally incentivised (nine such categories existing in France alone, all with tax incentives).
- Granting the “most favoured nation” clause to ELTIFs for its tax treatment in Member States
- Selling the same ELTIFs to all investors – retail or not, and ban funds of funds which add a layer of fees
- Applying the product disclosure rules of UCITS funds
- Making listed small cap equity an eligible asset class
- allowing as well closed-end listed ELTIFs to address the liquidity issue
- Setting a high threshold for minimum investments in ELTIFs: those should be “advised” only to qualified and very financially literate investors.
Once the legislation is formally in place (Official Journal publication and Level 2 implementing measures), ELTIFs can play an important role in capital market funding in the EU, but they need more official support. One of the major barriers ELTIFs will face in trying to develop into a genuine cross-border fund structure, with a UCITS-like passport, is the lack of a level playing field for non-bank providers of credit when compared to bank lenders. Because ELTIFs are intended to invest in illiquid, often private (as opposed to public) assets, ELTIFs may need to operate only nationally if at all, given the various national restrictions on banking law, insolvency law and tax regimes.

In order to encourage the take-up of ELTIFs, the Commission needs to encourage Member States to remove the following restrictions at national level, among others:

- the inability of funds to originate loans;
- the need for a banking licence to originate loans;
- bank liabilities preferred on bankruptcy;
- the lack of standardised procedures for taking security, enforcement and for creating loans/bonds, like EU company registers for registering and enforcing pledges and similar charges;
- restrictions on the availability of credit data, which can be restricted to only actors with banking licences; and
- different tax treatments on, for example, withholding tax on interest, depending on the type of investor.

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?

The SMSG needs to develop this section as no prior advice is available.

EU could undertake a review of the current obstacles to cross-border fundraising which have arisen through the implementation of the AIFMD. Investors who have indirectly invested in an SME from a different member state through a venture capital fund and whose development they have been able to closely follow, may be more inclined to invest directly into debt or equity issued by such SME at a later stage.

In addition to supporting market-led standards (such as the recent initiative from ICMA with the Pan-European Corporate Private Placement Market Guide published on 11 February 2015.), we suggest that a revision of the final calibrations for insurers of the spread risk capital weightings in the Solvency II Delegated Act (Commission Delegated Regulation (EU) 2015/35) should be considered. Although the final calibrations in the Delegated Act (the “long term guarantees package”) has helped remove obstacles to investing in certain long-term assets (infrastructure projects, SME loans or start-ups), the final calibrations are not optimal due to the focus on volatility risk as opposed to default risk, and also they do not sufficiently address private placements. The European Commission should lead a consultation process to determine the appropriate adjustments to the calibration of the current long term guarantees package in order to incentivise investment in private placements, as well as more generally in long-term assets.
Taking especially into account that private placements can be documented in both bond and loan format, the Commission should encourage Member States to remove the restrictions at national level also identified for 3) above.

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

The SMSG needs to develop this section as no prior advice is available.

Care needs to be taken to ensure that there are enough intermediaries, in the form of fund managers, providers of investment readiness programs etc, who can help bridge the gaps between institutional investors needing to deploy large amounts of capital and the relatively smaller amounts required by each SME as well as the relatively smaller amounts of capital to be invested by retail investors but still looking to spread their risks through diversification, eg rather investing through funds of funds or into portfolios of SME debt. Many SMEs and their management teams will need to better understand what investors are looking for as well as improve their corporate governance standards before they are ready to approach new categories of funders.

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?

The SMSG needs to develop this section as no prior advice is available.

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets. It is questionable whether standardisation in corporate bond markets would promote liquidity, and regulatory action is therefore not necessarily advisable. Borrowers seek to choose maturities and coupon structures to match their cash-flows. They also require freedom to negotiate terms that suit their own business model, their other financing obligations and documentation and their particular funding needs. Standardisation would make it harder for borrowers to achieve consistent borrowing on the best terms by restricting these fundamental capabilities and inhibiting funding flexibility.

Furthermore, standardisation may actually work against smaller issuers in corporate bond markets. Owing to their funding profiles, very frequent, large borrowers may in principle be qualified to issue on a standard schedule. However, to apply a broad-brush approach to all borrowers would be to disadvantage those smaller borrowers with their own particular funding habits. This would not only be inconsistent with the Capital Markets Union objective of expanding bond market access for smaller, mid-cap borrowers, but a push towards standardisation for very frequent, large borrowers could also lead to greater market segmentation, resulting in issuance of standardised bonds, on the one hand, while issues from the rest of the sector could come to resemble the more bespoke private placement market, on the other hand.

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?

The SMSG needs to develop this section as no prior advice is available.
As a preliminary comment, it is important to note that green bonds like any other listed bond come under the scope of existing financial regulation both at the EU and national levels. Green bonds are therefore not being issued in any form of regulatory void. They also benefit from a successful self-regulatory industry initiative known as the Green Bond Principles (GBP). The GBP provide voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of the green bond market by clarifying the approach for issuance. The GBP are a regularly updated document, most recently in March 2015 based on a broad consensus of market participants.

Also as a generic reference for other ESG bonds, the flexible and reactive market-driven process represented by the GBP is preferable to a top-down normative approach leading for example to a green bond "label" formally recognized at a regulatory level. This would risk creating unnecessary market segmentation, as well as the perception of potential liabilities for issuers that could dissuade them from entering the market.

There are reasons to consider creating future incentives for investors and issuers in the green bond market as they both experience additional costs compared to mainstream alternatives, and/or in order to maintain or accelerate the development of the market in support of wider public policy objectives related especially to the fight against climate change. The GBP require additional work from green bond issuers both during (e.g. process for project evaluation and selection) and after the transaction (e.g. dedicated reporting). Similarly, investors require additional resources to evaluate and monitor green bonds and the underlying environmental projects. These costs are not reflected in the economics of green bonds that are priced in line with the credit profile and mainstream bonds of the issuer.

The difficulty, however, in designing and implementing such incentives would be the need to agree most likely on some form of regulatory and/or legal definition of green bonds which may defeat the goal identified above of avoiding a top down normative approach to these securities.

At this stage, it is therefore most likely preferable to allow the green bond market to continue its development based on its current strong momentum and successful self-regulation (within the safeguards provided by mainstream financial regulation). An active dialogue can be maintained on the need for possible future incentives between the Commission and national authorities on the one hand, and industry associations and self-regulatory initiatives on the other.

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

The ESMA SMSG is in favour of the distinct and separate SME market regime under MiFID II and MAD

The SMSG believe that such a regime would have the following benefits:

- recognise the role such markets currently play in the EU funding environment;
- ensure that changes to EU financial services regulation do not adversely impact small caps;
- cater for a secondary market for trading shares of less liquid SMEs;
- allow for further development of regulatory and fiscal EU policies to attract investors to this asset class.

This does not regard accounting standards
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 one of the emerging financing models that contribute to helping start-ups move up the “funding escalator”, as it can be followed by other forms of financing, such as venture capital or an Initial Public Offering (IPO).

The expression “crowdfunding” does not apply to a specific financial vehicle but rather to a channel of financing, which can be used in many different ways. The terms refers to open calls to the wider public to raise funds for a specific project. These calls are often published and promoted through the internet, by means of specialized platforms, and try to attract a large number of contributors in the form of relatively small contributions.

Under those common elements, there are many different types of crowdfunding depending on the purpose of the fund raising as well as the instrument used to contribute the funds. The most widely used taxonomy distinguishes between non-financial and financial CF, the difference being what the providers of money get in return for providing funds:

- **Non financial crowdfunding**, includes all forms of money contributions where the provider of money is not expecting any financial return. Donations, sponsoring, or reward seeking (in the form of a product or service of lower value than the contribution) are among the most cited categories of non-financial CF.

- **Financial crowdfunding**, includes all those contributions where the provider of money expects some financial return. Among these are included loan-based (also known as peer-to-peer lending), and securities-based, also named investment crowdfunding. Securities issued may be shares or bonds. It is this category of crowdfunding the one that should be of concern to ESMA.

Investment based crowdfunding amounts to very small figures, when compared to non-financial one (around 5% to 10% of total crowdfunding is investment-based), but is showing important growth rates. Overall investment crowdfunding in Europe was estimated at less than 100 million euros in 2013, a figure representing less than 1% of total IPO market. More recent estimates of equity crowdfunding in the UK (Nesta, *Understanding Alternative Finance*, Peter Baeck, Liam Collins, Bryan Zhang, November 2014) point out to a doubling up of activity in 2014, though still reaching extremely small amounts (some 80 to 90 million pounds) when compared to IPO market, or venture capital.

Project owners raising finance through crowdfunding are usually very small firms, innovative or otherwise, and project sizes are also extremely small. In fact, most platforms through which these projects raise funds are themselves also relatively small business. According to the same Nesta report previously quoted, average deal size of an equity-based crowdfunding campaign in the UK has been around 200,000 pounds, with an average of 100 to 150 investors participating as contributors. The same UK data source shows that 60% of investors in equity crowdfunding described themselves as retail investors with no previous investment experience. Estimation of activity for the European Union is not easy, and overall
figures are probably much smaller than a pure extrapolation from UK figures. In fact, a large proportion of UK equity-based crowdfunding deals in 2014 were eligible for some of the existing schemes (EIS or SEIS) offering tax relief to investors in smaller higher risk companies. This illustrates the need to complement crowdfunding regulation with other measures (tax, rising awareness, etc.) addressed at promoting its usage as a financing vehicle. ESMA recently published an Advice on Crowdfunding to European Parliament, Council, and Commission taking into account the need of promotion and clarification, while at the same time preserving investor protection at its highest (http://www.esma.europa.eu/system/files/2014-1560_advice_on_investment-based_crowdfunding.pdf).

The main objective of the report is to assist NCA’s and market participants, and to promote regulatory and supervisory convergence around an activity which is relatively young, and business models are evolving. The report also identifies issues for consideration by policymakers in relation to the regulatory framework for crowdfunding at EU level.

Given the key role platforms perform in crowdfunding, the report is especially dedicated to the analysis of their activities, as they will determine the applicable legislation. The most likely activity identified is pure reception and transmission of orders, in which case a 50,000 euros capital requirement would be applicable. The report shows concerns about some platforms structuring business in such a way to avoid MiFID requirements, which could incorporate risks for investors not addressed at EU level. Additionally, the lack of a passport could also make it harder for platforms to achieve the scalability they need. In this sense, ESMA considers that an EU level regime should be desirable for platforms operating outside the scope of MiFID. Additionally, the report considers that the use of collective investment schemes in crowdfunding could become more widespread and so the relevance of AIFMD, EuVECA and EuSEF legislation could increase. Development of more detailed proposals would need to fit within the context of the Commission’s programme of work on the Capital market Union.

Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU-based platforms that could compete with the US ones.

Supply side: institutional investors

The Green Paper’s analysis of current regulation and tools
UCITS V and AIFMD
• The directives are still insufficient to reduce cost and diversify managed funds investment.

On pensions and insurance:
• There could be a review of Solvency II (and CRR) delegated acts, to adapt prudential rules for identified sub-classed of lower-risk infrastructure investment.
• The Commission asks which sub-classes should be prioritised for.

On professional pensions:
• Commission suggests introduction of a standardised product, via a 29th regime to remove barriers to cross-border access.

Private equity and venture capital:
• EuVECA and EuSEF Regulations - the clause impeding managers with portfolio above €500 million to apply to set up and operate such funds or use these designations to market the funds in the EU is harmful.
• Commission asks which measures could be proposed to: increase scale of venture capital funds (both via public and private contributions, improve exit strategies and supply for investors and boost supply of venture capital to start ups.

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

The AIFMD does not apply to private equity and venture capital funds under €500m (as these funds are typically closed-ended and unleveraged; if not - the €100 m threshold would apply) and is therefore not likely to impact the majority of European VC funds unless they need to opt-in in order to get access to the EU-wide marketing passport. However, the potential to be caught by AIFMD will deter funds from gaining scale which is ultimately needed to allow a fund to diversify and achieve attractive returns. US VC funds tend to be larger and therefore are able to back more enterprises and generate good returns. For example, Germany has only 4 independent VC funds >€100m compared to 227 in the US. The SMSG is aware that the AIFM Directive was controversial and would like to stress that although this report points out several negative consequences of the Directive, the intention is not to challenge what is already valid EU law, but to highlight what we see as unintended consequences in respect of SME’s that should and can be addressed by special measures directed as SME’s while respecting the intended scope and purpose of the Directive. 

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?

There needs to be better differentiation between the real risks profiles of different sets of assets/funds and thus also an ensuing differentiation in the capital requirement ratios for each asset class. In many EU countries there are still institutional barriers to larger investments by eg pension funds, insurance funds etc into alternative assets where limits are set as % of overall portfolio rather than eg following the so called prudent person rules.

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Earlybird Europe Venture Capital Report – July 2011
Incentives to create investment funds specialized in shares and/or debt of SMEs, for example through a more favourable tax regime and more flexible investment rules, possibly through closed-end funds, given the lower liquidity of the underlying assets.

There are 33,000 funds in the EU versus 800 in the US. The average size of an EU fund is about €200 million versus €1,600 million in the US, i.e., 8 times bigger. The annual fees of EU equity funds are 170 bps (2011: last available info) versus 74 bps in the US (2013).

The number of funds must be drastically reduced, especially AIFs as they are more numerous (about 20,000), smaller and often only distributed on a national basis. For example, Better Finance is proposing to ban AIFs in retail packaged products such as unit-linked insurance contracts and pension plans, in favour of UCITS.

For individual EU investors the problem is compounded by the fact that direct fund holdings account for only 7% of their financial assets: most economic retail ownership of funds is through wrappers that add yet another layer of costs further reducing the net returns to EU citizens.

Review of the tightening of the national private placement regimes for cross-border marketing of especially below threshold funds that followed as a result of the implementation of the AIFMD. Review of the practice of many national CAs to impose additional charges and/or additional conditions (like a French paying agent) for managers who have already been granted the EU passport in their home jurisdiction.

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?

EU Regulation applicable to institutional investors (such as Solvency II for insurance funds) and any future proposals to introduce similar regulation for pension funds must not place conditions that adversely impact the ability to directly or indirectly invest in small caps. The capital and liquidity requirements under Solvency II are likely to exacerbate the tendency of institutions to only hold the largest and most liquid blue-chip equities or even only interest-bearing instruments like government bonds due to the lower risk weightings for these than equities in general and deter any existing appetite for smaller companies. An appropriate exemption for direct or indirect investment in small cap securities should be implemented.

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

Yes
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?

The European Venture Capital Funds Regulation (EVCFR) and Social Entrepreneurship Funds (EuSEF) Regime aim to provide an EU-wide marketing passport to qualifying funds thereby enabling institutional investors across the EU to indirectly invest into SMEs. We support the current proposal that includes holdings in SME markets as ‘qualifying portfolio companies’. This will allow VC funds to appropriately consider their exit options (including via IPO) and provide them with the flexibility to follow portfolio companies even after IPO, as appropriate. Also the criteria of the MiFID definition of Professional Investor need to be adapted so as not to exclude traditional investors into VC funds like entrepreneurs and business angels who bring both funds and relevant experience, but none of which make 10 commitments to invest in a VC fund per quarter (not even the largest Institutions do) nor have necessarily worked in the financial industry.

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 SMSG needs to develop this section as no prior advice is available.

As mentioned above through not imposing overly restrictive capital requirement, not reflective of the actual risks, on the different types of institutional investors typically investing in the asset class. Adapting the MiFID definition of professional investor to better suit traditional investors into VC funds (business angels, entrepreneurs, family offices, HNIs etc) or introduce a harmonized definition of semi-professional investor.

Using public capital to leverage private capital through allocating investment funds to such fund managers with a proven track record of raising private funding and successfully investing it in SMEs. This is especially important in the earlier and more risky stages of SME funding to ensure there are funds catering for the different stages of a company’s development before it is mature enough to list/do an IPO. While many start-ups manage to find funding for the seed and incubator stage only too often do they later run into the “valley of death”...

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

The SMSG needs to develop this section as no prior advice is available.
Supply side – retail investors

- Commission asks how to increase participation in UCITS by cross-border retail; 
- Share best national best practices in the development of simple and transparent investment products for consumers; 
- The Commission suggests that in the review of the ESAs their mandate in consumer/investor protection could be enhanced. Commission announces vaguely it will begin preparatory work on the single market for retail financial services.

17) How can cross border retail participation in UCITS be increased?
Review of UCITS directive to identify ways to attract dedicated UCIT funds for small caps. For example, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability to be marketed to retail investors. This would have the advantage of attracting retail funds to the SME sector through a vehicle which is subject to the well-established UCITS investor protection regime, and of avoiding the potential liquidity and other risks which might follow were retail investors to be encouraged to make investments directly in SME issuers.

UCITS are much more cross-border than AIFs already because the two major domiciles for UCITS are largely "off-shore": Luxembourg and Ireland (i.e., most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. One way to increase cross-border distribution of funds in the EU is therefore to drastically reduce the number of retail AIFs (see reply to 11 above).

18) How can the ESAs further contribute to ensuring consumer and investor protection?
The SMSG needs to develop this section possibly based on prior advice if available.
ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors. They should also better enforce existing investor protection rules. For all this they need their resources to grow, not to be cut.

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

General comment
The saving rate of household is already quite high in Europe. Also, contrry to what one often reads, individual investors are not more short termist nor more risk averse than other investors.
62% of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80% of their total savings are long term if property is taken into account. DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least). By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8% from 2001 to 2010: way before Solvency II. The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership. What individual investors do not like it high risk – low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the firsts category returned a net real after tx return of 20% since 2000, the latter a negative one of minus 14% over the same period.

- Review of categorisation of high net worth individuals/business angel type investors as ‘retail’: The criteria to assess retail clients that request to be treated as professionals are not entirely relevant to early stage/small cap investors. This assessment increases the cost of investment and disenfranchises an important set of investors from small caps. A review would also help to ensure that appropriate exemptions are made for venture capital fund managers (and their end investors) in the AIFMD and the EuVECA and EuSEF passporting schemes.

- Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMES, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Further investigations of ways to remove factual double taxation of dividends and interest in case of cross-border investments by reviewing cross-border refund/exemption procedures for withholding taxes on dividends and interest would be a further step to encourage cross-border investments.

- Recreate trust in capital markets. Investor protection is a key driver of EU financial legislation and will serve to revive confidence in financial markets. Only when investors feel adequately protected they will be willing to channel their money into capital markets. To that end it is necessary to repeal barriers to cross-border shareholder engagement, e.g. by facilitating the exercise of shareholders’ voting rights cross-border which is still cumbersome and costly, by introducing common minimum corporate governance standards, and by encouraging Member States to introduce minimum standards, e.g. in relation to insolvency law.

- Development of a collective redress mechanism, similar to the Dutch collective settlement procedure/collective action.
• Improvements in the quality and quantity of financial education by advocating/fostering respective initiatives.

One should look at differentiating the capital gains tax regimes so that lower capital gains taxes are incurred when holding a share for 3 years or longer. While interest payments are typically (wholly or partially) tax-deductible expenses for a company and then taxed in the hands of the recipient, dividends are subject to double taxation (made out of taxed corporate profits and then taxed again in the hands of investors).

20) Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?
The SMSG needs to develop this section possibly based on prior advice if available.

To our knowledge, the longer term the retail investment products are the more complex. This is why a simple, standardized Pan-European personal pension plan is needed.

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?
The SMSG needs to develop this section possibly based on prior advice if available.

Yes:
- The PRIIPs Regulation should include shares, bonds and pension funds in its scope to further standardise and simplify pre-contractual investor information, or, at least, the Prospectus, Insurance Mediation and IORP Directives should be amended in order to make their summary documents more standardised, simpler, shorter, in Plain English and more comparable between each other and with other investment products.
- IMD 2 and IORP 2 conduct of business rules should be fully aligned to those of MiFID 2.
- The Shareholders Rights Directive should be amended to facilitate the exercise of voting rights cross-border, and in nominee/omnibus accounts, and free-up the right of small shareholders to freely associate and for these shareholder association to easily collect proxies from their members.
Supply side – non-EU investment

Attracting non-EU investment:
• The Commission notes that EU markets must be open and globally competitive to attract foreign investments.
• The EU has undergone a sizeable decline in the amount of gross capital inflows as a % of GDP, the gross capital inflows were lower in 2013 than in 2007.

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

The SMSG needs to develop this section possibly based on prior advice if available.

EU needs to continue to ensure “reciprocity”, ie not to discriminate against non-EU based managers thereby making it less attractive for them to market their funds to EU-based investors. Non-reciprocity could also result in it becoming more difficult for EU-based managers to market Internationally.

Given that many regulatory initiatives are newly implemented in Europe, and taking into account that markets have become global, the topic of third-country recognition is important. In general, the same level of requirements for third-country enterprises providing their services in a European Member State should be maintained in order to preserve the desired standards of services in the EU. The potentially lower standards from third countries for the same services should not be introduced via recognition procedures. This is particularly sensitive with regard to foreign competition, affecting the growth potential for EU companies.

Therefore, a fair balance needs to be found to allow non-EU companies to provide their services in Europe.

It is important to ensure that global standards and rules put in place by institutions such as the International Organization of Securities Commissions, the Bank for International Settlements and the Financial Stability Board are carefully considered when drafting regulation in order to avoid regulatory arbitrage that could have negative consequences for growth. Safety standards, risk mitigation measures and data protection rules, for example, should be put in place at the highest level possible. A “race to the bottom” should be avoided, so that individual players cannot exploit weak regulatory regimes. Isolated national regulation should be avoided as well.

On the other hand, it is important that European companies are allowed to enter third country markets to provide services abroad. It should be noted that other countries may have high barriers of access to their markets, which is another reason to consider initiatives to ensure that EU market participants are able to offer their services outside the EU on a level playing field with non-EU providers.

In this regard, reciprocity should be requested and maintained with regard to third-country regimes.

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?

The SMSG needs to develop this section possibly based on prior advice if available.
Improving the investment chain

Commission’s analysis regarding the single rule book, enforcement and competition includes:

- The single rulebook is a major step forward to enforce EU regulation consistently but the single rulebook’s success depends on consistent implementation and enforcement.
- Supervisory convergence: the ESAs play an important role to ensure a level playing field. Active use of dispute settlement is needed – but more may be needed in a more integrated CMU.
- Common Data and reporting across the EU will help the CMU – common IT approaches for reporting requirements would help the CMU.
- Market infrastructures are regulated by CSDR, EMIR and T2S. The Commission is working on CCP recovery and resolution. The fluidity of collateral across the EU is currently restricted. Where there may be potential to make further improvements.

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

The SMSG needs to develop this section possibly based on prior advice if available.

Regulatory reconciliation is a key in the next years.

The Capital Markets Union should ensure that the long-term goal is to reduce the regulatory burden to what is essential. Additionally, loose ends need to be reconciled with regard to finalisation, implementation and application of existing regulatory initiatives, making sure that these avoid any unintended consequences.

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

The SMSG needs to develop this section possibly based on prior advice if available.

Is the current governance structure the optimal to ensure that eg ESMA has the necessary powers to drive regulatory convergence allowing it also to "crack-down" on national CAs who go further than what has been envisaged under certain Directives?

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?

The SMSG needs to develop this section possibly based on prior advice if available.

The overall legal framework for securities varies widely by country. For example, legal barriers make it much more complex to hold securities cross-border, and lead to higher costs for transactions. In addition, they cause difficulties and uncertainty among investors when they exercise their rights abroad.

Given that legal uncertainty of this nature acts as a barrier to financial stability and growth, the European Commission has been examining barriers within securities markets for several years, with the aim of creating a stable and efficiently functioning single market;
Continued harmonisation of rules and standards is essential to eliminate costly barriers and reduce complexity for investors and companies. Initiatives in this area, building on the Single Rulebook as a harmonised regulatory framework, should increase the attractiveness and returns on investment, thereby stimulating economic growth.

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

The SMSG needs to develop this section possibly based on prior advice if available.

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 SMSG needs to develop this section possibly based on prior advice if available.

The varying degree of transparency on company reporting for example. Whereas in some countries like Sweden any and all (irrespective of whether public or listed and size) company statutory reporting info for the last 12 years is available (for purchase) via the web-site www.allabolag.se as is info on Directors, credit ratings etc this is not the case throughout the EU.

Language is another impediment.

Despite significant progress towards the European single market, capital markets are still fragmented with regard to company law, corporate governance rules, creating barriers that hamper the free flow of capital. Those barriers across regions make cross-border investments complex and expensive, and therefore less attractive. The Single Rulebook has not yet been fully achieved.

Continued harmonisation of national rules and standards in order to eliminate costly barriers and reduce complexity for investors is essential.

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

The SMSG needs to develop this section possibly based on prior advice if available.

Different national insolvency laws make cross-border services expensive. Reducing the existing inefficiencies will play an important role in unleashing the wider macroeconomic benefits from integrating European securities markets.

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?

- Eliminate the double taxation of cross-border dividends and interests within the EU and end tax discriminations against EU investors domiciled in another Member state than the investment provider.
Review of EU State Aid risk capital guidelines to allow for effective incentive schemes to be adopted by Member States. The guidelines should recognise the role of expansion capital as genuine risk capital. Tax reforms may be considered in order to encourage more long-term holdings (i.e. better pre-tax off-setting of gains and losses, and tax push forward if realisation proceeds are re-invested). Creation of specific benefits to certain investors who can invest in SMEs, tax relief or personal internal revenue taxes lower on capital gains on securities of these companies, under conditions of maintenance of such securities over a minimum period of time and a maximum concentration by company (in value and in percentage of capital of each company). Exemption of certain investment rules imposed on certain investors in the case of investments in SMEs (e.g., minimum ratings, liquidity of securities, etc.). This would need to be balanced with any risk of misallocation of capital.

The Financial Transaction Tax would increase transaction costs in European financial centres and could therefore impede the goals of the Capital Markets Union. SMEs in particular would face higher capital raising costs as a result of rising transaction costs. Retail investors would also suffer greater financial losses as the tax directly hits retirement provision products. Further, if the financial transaction tax, is introduced in 11 Member States this contradicts the harmonisation intentions within the European Union. However, if introduced, it should not apply to SME transactions. Given that investors in smaller companies usually require a higher rate of return on investment, an additional tax would have a disproportionate increase in the cost of capital for smaller companies and is likely to deter investors from this asset class.

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? The SMSG needs to develop this section possibly based on prior advice if available.

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?

MiFID has posed serious challenges to the bank and broker intermediation chain potentially harming local funding ecosystems

With regard to Regulated Markets and MTFs, the increased transparency included in regulation such as MiFID represents a challenge for SMEs, resulting in a suboptimal time allocation for SMEs' board and management and ensuing increased costs of accessing public markets. In addition, MiFID has also heightened the pressures faced by small and medium sized intermediaries in respect to their cost base, the very ones that were traditionally the ones most involved in SME research activities.

The Elite programme, which was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group, could be a partial solution to the lack of support from the local intermediation chain. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the UK in 2014, where it now counts 33 participants.
Elite is a program aimed at preparing growing Companies to the task of raising finance outside the close relationships of the founders. It includes a training program, a “work zone” supported by a tutorship model and direct access to the financial community through dedicated digital community facilities. It is “capital neutral” to any financing opportunity, facilitating access to Private Equity, Venture Capital, debt products, listing on markets, etc.

It is made up of different phases:

• **1° phase - GET READY**: It consists of a comprehensive training programme for founders and managers delivered by academic professionals, industry experts and other entrepreneurs to stimulate cultural and organizational change, understand the language of the financial community and help in evaluating long term financing opportunities.

• **2° phase - GET FIT**: New management practices, financial competencies and governance structure are gradually introduced in order to be able to deal with investors with the support, where appropriate, of a dedicated external advisory team.

• **3° phase – GET VALUE**: Companies capitalize on the benefits associated with the new model and access new businesses, networking opportunities and funding options, thanks to the European ELITE community of advisers, investors and stakeholders.

Elite was started in 2012 by Borsa Italiana, part of the London Stock Exchange Group. At the end of last year, 176 businesses had joined the program in Italy; it is supported by a network of 70 advisors and 120 investors. The average yearly turnover of Italian Elite companies is 124 mn €, ranging from the smallest (6 mn €) to the largest (1,2 bn €); their average Ebitda amounts to 15% and exports total 45%. Elite Companies have been involved in one Aim listing, 13 private equity investments and 10 small corporate bond issues. Elite has been introduced in the UK in 2014, where it now counts 33 participants. In December 2014 Borsa Italiana and the London Stock Exchange Group have presented the imminent launch of a Europe-wide Elite program at the European Parliament; it will be a European platform deeply rooted in each domestic market, through partnerships with local institutions enabling companies to access support and advice throughout Europe.
Dear members of the SMSG,

this bibliography of studies on HFT has been published recently.

The results and documents are (unsurprisingly) not very supportive of the activity of HFT.

I thought that it might be of interest to our own discussions.

Kind regards,
High Frequency Trading

A bibliography of evidence-based research

March 2015
# Contents

Preface ................................................................................................................................. ii
Research Overview............................................................................................................. 1
  Volatility ......................................................................................................................... 1
  Manipulation ................................................................................................................... 2
  Market Quality .............................................................................................................. 2
  Investor Costs ................................................................................................................. 4
Evidence-based Research Bibliography ............................................................................. 6
The Wall Street Journal's "Dark Market" Series (selected articles) ......................................... 28
High Frequency Trading and "Insider Trading 2.0" ............................................................... 29
Press Editorials .................................................................................................................. 30
Op-eds and Commentary .................................................................................................. 32
Books and Documentaries ............................................................................................... 42
"Flash Boys" by Michael Lewis ......................................................................................... 44
  60 Minutes ...................................................................................................................... 44
  Reviews .......................................................................................................................... 44
  CNBC ............................................................................................................................... 45
  Interviews ....................................................................................................................... 45
  Other interviews ............................................................................................................ 45
"Flash Boys": Supporting Evidence .................................................................................. 46
Government Reaction to HFT ........................................................................................... 48
  Central Banks ................................................................................................................ 48
  Regulators ...................................................................................................................... 49
  Legislators ..................................................................................................................... 51
  Prosecutors ................................................................................................................... 52
  Other ............................................................................................................................. 53
High Frequency Trading Defined ...................................................................................... 54
  Industry Participants .................................................................................................... 54
  Academics ..................................................................................................................... 54
  Regulators .................................................................................................................... 55
Preface

This is a bibliography of resources on the capital markets, particularly on some of the negative effects of high frequency trading (HFT). Since the December 2013 edition of this document there has been an explosion of fact-based evidence on the damaging effects of HFT. This year’s bibliography highlights a wide variety of academic, government, and industry data-driven research from institutions around the world, including MIT, Harvard, Princeton, the Federal Reserve Bank, the Bank of England, the University of Chicago, BlackRock, Cornell, the SEC, the European Central Bank, Yale, Cambridge, the London School of Economics, the United Nations, and many others.

Research listed here also explores how the most common business model employed by today’s high frequency traders - unregulated or under-regulated market making, often called “scalping” - can be abusive and disruptive. Several of these studies even predate automation.

Along with evidence-based research, separate sections of this bibliography include press editorials, op-eds, other commentary, and a variety of statements from government bodies and government officials from around the world about high frequency trading.

The bibliography begins with a brief overview of the evidence-based research. A detailed research bibliography containing over 100 studies begins on page six. Please also note various industry, academic, and government definitions of high frequency trading listed in the final section of this document, and note the special section on Michael Lewis’s “Flash Boys.”

R. T. Leuchtker
March 2015
Research Overview

Volatility

In a 2010 study of the 2010 Flash Crash, the U.S. Securities and Exchange Commission and the Commodity Futures Trading Commission found that high frequency traders substantially increased volatility during the event and accelerated the crash. Kirilenko et al. (2014) studied the 2010 Flash Crash and found the same, concluding that high frequency traders "can amplify a directional price move and significantly add to volatility." Menkveld and Yueshen (2015) confirmed the U.S. government's and Kirilenko's narratives about the Flash Crash. Madhavan (2012) examined almost two decades of U.S. equities data and wrote that "The link to higher frequency quotation activity and the current high levels of fragmentation help explain why a Flash Crash did not occur before and offers a counterpoint to the view that the Flash Crash stemmed from an unlikely confluence of events." The Australian Securities and Investments Commission, the stock market regulator in Australia, found in a 2012 study that during volatile markets high frequency traders reduce their liquidity supply and increase their liquidity demands. After studying a decade's worth of U.S. data, Hasbrouck (2015) found that high frequency quoting increased a measure of intraday volatility by a factor of two or more.

The Bank for International Settlements looked at foreign exchange markets and concluded in a 2011 study that high frequency traders exacerbate volatility in stressed markets. Ben-David et al. (2012) studied 14 years of U.S. equity data and concluded that "HFT can be highly destabilizing as it propagates shocks across markets at very high speed." Bichetti et al. (2012) examined 15 years of U.S. equities and futures data and determined that HFT strategies cause assets to "deviate from their fundamentals." Boehmer et al. analyzed nine years of stock market data from 37 countries and in a 2012 paper concluded that algorithmic trading, including high frequency trading, caused higher volatility. Zhang (2010) studied 25 years of U.S. stock market data and determined "high-frequency trading is positively correlated with stock price volatility." Huh (2014) found that high frequency traders withdraw during volatile markets, which exacerbates volatility. Kang and Shin (2012) looked at the Korean futures markets and concluded that "massive use of limit orders including revision and cancellation by high frequency traders may potentially have negative effects on the market."

The U.K. Government Office for Science published a large 2012 study of capital markets around the world and concluded that "HFT/AT may cause instabilities in financial markets in specific circumstances." Golub et al. (2011) looked at six years of U.S. stock market data to study mini flash crashes and determined that "Given the speed and the magnitude of the crashes, it appears likely that Mini Flash Crashes are caused by HFT activity." Easley et al. (2011) found that high frequency traders can exacerbate price volatility when they dump inventory and withdraw from volatile markets, and that flash crashes will recur because of U.S. market structure. Chung et al. (2012) studied U.S. stock market data from two decades and wrote that higher volatility in asset prices in recent years is due in part to "the increased role of high-frequency traders." Brekenfelder (2013) studied Swedish equities and found that intraday volatility increased substantially when high frequency firms came to Sweden. Bain and Mudassir (2013) found that though high frequency traders might narrow spreads, they increase intraday volatility, and noted "an approximate doubling of short-term volatility resulting in higher implicit execution costs for investors."

Benos and Sagade (2012) found that aggressive high frequency trading increased volatility in U.K. stock markets. Benos and Weatherilt (2012) found that "the de facto high-frequency market makers that have
entered markets following technological advances are free to enter or exit the market at will. This allows them to compete with DMMs when market-making is profitable but withdraw altogether from the market when it is not..." Nanex (2010-2013) has analyzed U.S. trading data from 2006 onward and found thousands of events where individual stocks experienced unexplained violent price swings. Weller (2012) looked at U.S. futures data and wrote that "the introduction of fast, low capital intermediaries [high frequency traders] can render markets less able to bear large liquidity demand shocks." The Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues (2011), which included two Nobel laureates, examined U.S. market structure and data from the Flash Crash and wrote "In the present environment, where high frequency and algorithmic trading predominate and where exchange competition has essentially eliminated rule-based market maker obligations, liquidity problems are an inherent difficulty that must be addressed. Indeed, even in the absence of extraordinary market events, limit order books can quickly empty and prices can crash simply due to the speed and numbers of orders flowing into the market and due to the ability to instantly cancel orders." Golub et al. (2012) examined U.S. equities data from 2006 through 2011 and found "strong evidence that Mini Flash Crashes have an adverse impact on market liquidity and are associated with Fleeting Liquidity." Raman et al. (2014) looked at U.S. futures data and concluded that "in sharp contrast to the erstwhile locals in futures pits, electronic market makers reduce their participation and their liquidity provision in periods of significantly high and persistent volatility....our results raise the question whether exchanges and regulators should consider affirmative obligations for hitherto voluntary market makers."

Manipulation

Egginton et al. (2012) found systematic evidence of "quote stuffing," a term coined by the market data and research firm Nanex to describe the many events it found where exchange technology infrastructure was slowed by floods of order and order cancel activity. They wrote that "We find that quote stuffing is pervasive with several hundred events occurring each trading day and that quote stuffing impacts over 74% of US listed equities during our sample period," and found that "stocks experience decreased liquidity, higher trading costs, and increased short term volatility." Direct Edge (2013) launched a service to help its customers "mitigate the risks" of quote stuffing. Tse et al. (2012) "present a detailed study of a variety of negative HFT strategies including examples of Quote Stuffing, Layering/Order Book Fade, and Momentum Ignition to demonstrate what bad HFT 'looks like', how often it happens, and how we detect it." Ye et al. (2013) analyzed U.S. stock market data from 2010 and found "that stocks randomly grouped into the same [technology] channel have an abnormal correlation in message flow, which is consistent with the quote stuffing hypothesis." Industry regulator FINRA (2014) alleged a firm's high frequency trading customers employed "aggressive, potentially destabilizing trading strategies in illiquid securities." The United States Securities and Exchange Commission (2014) sanctioned a high frequency trading firm for manipulating the closing prices of thousands of stocks over a six month period.

Market Quality

Baron et al. (2014) studied U.S. futures data and found a "winner-takes-all market structure" where "HFTs have strong incentives to take liquidity and compete over small increases in speed in an industry dominated by a small number of incumbents earning high and persistent returns." Biais and Foucault (2014) "recommend developing trading mechanisms that cate specifically to slow traders" and said "This could require regulatory intervention to overcome exchanges' conflict of interests." Kim and Murphy (2013) examined more than a decade of U.S. stock market data and found that after controlling for changes in market dynamics in that time period, market spreads were much worse than have been reported. Kirilenko and Lo (2013) surveyed the research literature and concluded that "In contrast to a number of public claims, high frequency traders do not as a rule engage in the provision of liquidity like
traditional market makers." Lee (2013) analyzed Korean futures data and found that "high frequency trading is detrimental to the price discovery process." Machain and Dufour (2013) investigated U.K. stock market data and found empirical evidence for "a minimum period of time a limit order should be kept on the order book to avoid speculative practices." McInish and Upton (2012) explored U.S. equity data and wrote that "the ability of fast liquidity suppliers to use their speed advantage to the detriment of slow liquidity demanders...unambiguously lowers market quality." Yildiz et al. (2014) "provide empirical evidence to support the theoretical predictions...that HFTs may play a dysfunctional role in financial markets." Van Kervel (2014) studied U.K. data and found that "trades are followed by excessive cancellations of limit orders, and the magnitude depends on the fraction of traders who can access several venues simultaneously" and "high-frequency traders can observe the first part of the trade and quickly cancel outstanding limit orders on other venues before the second part of the trade arrives." After analyzing U.S. stock market data, Ye et al. (2013) concluded that speed improvements do not improve spreads but do increase cancellations and volatility. Johnson et al. (2013) "uncovered an explosion of UEEs [ultrafast extreme events] starting in 2006, just after new legislation came into force that made high frequency trading more attractive."

The Australian Securities and Investments Commission (2013) reported that it found "some examples of potentially predatory activity" and that it aggressively intervened with high frequency trading firms to change their trading practices. Its efforts caused a "behavioural change by traders which has had a marked effect on market quality," including a 40% reduction in volatility in one part of the trading day. Boehmer et al. (2012) studied trading data from around the world and discovered that "algorithmic traders can have impact beyond the immediate trading environment and potentially affect the more fundamental functions of capital markets, such as the allocation of capital to firms." Boni et al. (2012) found that excluding high frequency traders from a market center resulted in lower volatility, less front running, and higher execution quality for institutional traders. Boulton et al. (2012) analyzed U.S. stock market data from 2010 and discovered that "seemingly fleeting events, such as the flash crash, can have dramatic and lingering effects on shareholder wealth and market quality." Clark-Joseph (2013) explored U.S. futures data and found that "Aggressive trading is a tremendously important component of HFTs' activity. In aggregate, approximately 48.5% of HFTs' volume is aggressive, and this figure rises to 54.2% among the 12 largest HFTs." Gerig (2015) studied U.S. equities and concluded that "HFT appears to make the financial system as a whole more fragile."

Nasdaq (2012) "observed that upon partial execution of a routable order at NASDAQ...market participants often react to the order by cancelling their orders on other markets and entering new orders at inferior prices." (A senior executive of a high frequency market maker, who is also head of an industry lobbying group, not long ago wrote "If I quote on 8 exchanges and get hit on one, I will update 16 prices. That is main reason for high [cancel] rates," offering strong evidence for Nasdaq's point; he then later confessed "market makers offer more liquidity than they're prepared to trade in one go.") Nanex (2014) analyzed the impact of one trader's order and found "sell orders simply disappeared before the exchanges processed his buy order."

For a $12 million penalty, Knight Capital, one of the largest high frequency market makers in the world, settled charges in October 2013 with the U.S. Securities and Exchange Commission that Knight "did not have adequate safeguards in place to limit the risks posed by its access to the markets, and failed as a result to prevent the entry of millions of erroneous orders." For a combined $375,000 penalty, the U.S. subsidiary of the Dutch firm IMC, one of the largest high-frequency market makers in the world, settled charges in April 2013 with four U.S. stock exchanges including Nasdaq (2013) that it failed "to establish and maintain adequate supervisory procedures, including written supervisory procedures, and a
reasonable system of follow-up and review, related to the oversight of the Firm's high frequency and algorithmic trading," as one of the settlements detailed. In July 2012, the **Hong Kong Securities and Futures Commission** fined an IMC subsidiary HK$1.5 million for "regulatory breaches and internal control failings." For a $450,000 penalty, Getco, one of the largest high frequency market makers in the world, settled charges in March 2012 with **Nasdaq** that one of its subsidiaries "failed to establish and maintain a reasonable supervisory system, including but not limited to its written supervisory procedures and supervisory and operational risk control systems related to the oversight and operation of high frequency trading and algorithmic trading." The **CBOT** found that a firm let a malfunctioning system run uninterrupted for 90 minutes while it sent "an excessive number of orders and cancel messages....[accounting for] 88% of the messaging volume in the contract" and shut the system down only after the exchange contacted the firm.

In July 2013 **FINRA** and four U.S. exchanges fined Newedge USA a total of $9.5 million because the firm "failed to establish, maintain and enforce adequate supervisory systems and procedures, including written supervisory procedures that were reasonably designed to achieve compliance with applicable securities laws and regulations, including FINRA and exchange rules, addressing anti-money laundering and other potentially manipulative and suspicious trading activity by the Firm's DMA [electronic direct market access] and SA [sponsored access] clients, such as spoofing, marking the close, excessive repetitive order entry, and wash sale transactions, numerous instances of which may have occurred on as many as four exchanges." In November 2011 the **CME Group** fined Infinium Capital Management a total of $850,000 because, in part, the firm allowed "a malfunctioning ATS [automated trading system] to operate in a live trading environment." In August 2013 the **China Securities Regulatory Commission** fined Everbright Securities $85 million for "serious flaws" in its trading systems and controls that "directly affected the normal order of securities markets and caused violent stock price fluctuation" that jolted investors.

The **U.S. Federal Reserve Bank of Chicago** studied a variety of proprietary trading firms, including high frequency firms, and wrote in 2012 that "some firms do not have stringent processes for the development, testing, and deployment of code used in their trading algorithms" and that "out-of-control algorithms were more common" than it expected.

The **United States Securities and Exchange Commission** (2015) levied its largest fine ever against a stock exchange for giving "information about certain order types only to some members, including certain high-frequency trading firms that provided input about how the orders would operate."

**Investor Costs**

The **Industry Super Network** is an association of Australian mutual funds. In a 2013 study, it estimated that high frequency traders cost long-term Australian investors an average A$1.6 billion a year. **Norges Bank Investment Management** (2013), one of the largest funds in the world with nearly $1 trillion under management, surveyed the research literature and concluded that "issues of concern to large, long-term investors more deserving of attention include — Anticipation of large orders by some HFTs leading to potential adverse market impact — Transient liquidity due to high propensity for HFTs to rapidly cancel quotes real-time — Un-level playing field amongst market makers from low latency ultra HFT strategies."

**Pragma Securities** (2012) examined U.S. stock trading in 2011 and 2012 and concluded that "high frequency traders' ('HFTs') profits come at the expense of investors."

**Nanex** (2013) detailed episodes where high frequency traders had market-moving information worth
millions ahead of other investors despite widespread beliefs they did not. Rogers et. al. (2014) found that the SEC provided corporate filings to high-speed traders before providing them to the public. McInish and Upton (2012) looked at U.S. stock market data and "show empirically that latency differences allow fast liquidity suppliers to pick off slow liquidity demanders at prices inferior to the NBBO." Hirschey (2013) examined U.S. stock market data and wrote that his analysis provides "evidence supporting the existence of an anticipatory trading channel through which HFTs may increase non-HFT trading costs." Gao and Mizrach (2013) found that high frequency traders are more profitable when they trade against long-term investors than when they trade with other high frequency firms. The Quantitative Services Group (2010) examined U.S. equity data and reported that "Changes in the microstructure of equity markets and the emergence of HFT competitors have changed the nature and magnitude of transaction costs. Sophisticated pattern recognition algorithms now present a real return burden to active equity managers."

Tong (2013) studied U.S. stock data and found "strong evidence that HFT increases the trading costs of institutional investors." Brogaard et. al. (2012) studied U.K. equities data from 2007 to 2011 and found that while institutional trading costs had declined in the period, high frequency trading had nothing to do with it. Budish et. al. (2013) looked at U.S. futures and equities data from 2005 to 2011 and "show that the [HFT speed] arms race is socially wasteful – a prisoner’s dilemma built directly into the market design – and that its cost is ultimately borne by fundamental investors via wider spreads and thinner markets." Ding et. al. (2013) compared the relative speeds of national utility data feeds (typically used by long-term investors) and exchange proprietary data feeds (typically used by high frequency traders) and found a substantial advantage for the proprietary data feeds, "While price dislocations have small effects on infrequently trading investors, investors that are continuously in the market [such as mutual funds] can be substantially disadvantaged." Menkveld and Zoican (2014) analyzed several European equities markets and wrote "a faster market implies more interaction among HFTs, i.e., their market participation increases and, more importantly, transaction cost for ‘low frequency’ investors increases as a result." Toulson (2013) examined European equities and found that HFT firms reacted to asset manager orders by cancelling their own orders and trading in front of the asset manager.
<table>
<thead>
<tr>
<th>Author(s), Title, Year, Affiliation (first author)</th>
<th>Evidence</th>
<th>Relevant findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia Industry Super Network, <em>Some Costs of High Frequency Trading in Low Latency Markets</em> (2013)</td>
<td>Australian equities, 2012</td>
<td>&quot;ISN estimates that HFT activities cost non-HFT market participants, including Australian long-term investors such as super funds [mutual funds], up to $1.9 billion per year, with a best estimate of over $1.6 billion per year.&quot;</td>
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<tr>
<td>Australian Securities and Investments Commission, <em>Report 331: Dark liquidity and high-frequency trading</em> (2013)</td>
<td>Australian equities, 2012</td>
<td>&quot;High-frequency traders reduce their passive liquidity provision (price-making) during relatively volatile periods, but remain active as liquidity takers.; &quot;Our analysis of high-frequency liquidity has detected some examples of potentially predatory activity...The traders, in these instances, have, in some cases responded positively to our intervention by modifying their algorithms, ceasing all trading in the market and in other cases they have been referred to Enforcement for investigation. In any case, we have seen behavioural change by traders which has had a marked effect on market quality.&quot;</td>
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<tr>
<td>Bain, Mudassir, <em>Evolution of Canadian Equity Markets</em> (2013)</td>
<td>Canadian equities, 1996-2013</td>
<td>&quot;Our study shows that the apparent benefits of higher volume and narrower spreads have come at the expense of increased relative intraday trading volatility. We believe this volatility constitutes a substantial hidden cost for natural investors and raises serious questions about the true costs and benefits of narrowed spreads.&quot;</td>
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<td>Bank for International Settlements, <em>High frequency trading in the foreign exchange market</em> (2011)</td>
<td>Foreign exchange, 2010 and 2011</td>
<td>&quot;HFT has had a marked impact on the functioning of the FX market in ways that could be seen as beneficial in normal times, but also in ways that may be harmful to market functioning, particularly in times of market stress.&quot;</td>
</tr>
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| Baron, Brogaard, Kirilenko, *Risk and Return in High Frequency Trading* (2014) | U.S. futures, 2010-2012 | Large, established HFT firms trump new competition; the industry over time stays concentrated in a few hands; measures of industry concentration are as high or higher than in the "bad old days"; "HFT returns are highly persistent, while risks are kept very low through tight inventory control and rapid turnover of contracts. HFT profits accumulate to the fastest and most aggressive liquidity-taking incumbents, while new entrants are less profitable and more likely to exit...Our results
suggest that HFTs have strong incentives to take liquidity and compete over small increases in speed in an industry dominated by a small number of incumbents earning high and persistent returns."

See also "Testimony of Andrei Kirilenko Professor of the Practice of Finance Sloan School of Management Massachusetts Institute of Technology Before the Senate Committee on Agriculture, Nutrition & Forestry Hearing on High Frequency and Automated Trading in Futures Markets," May 13, 2014

<table>
<thead>
<tr>
<th>Authors</th>
<th>Topic</th>
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<th>Notes</th>
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<tbody>
<tr>
<td>Ben-David, Franzoni, Moussawi</td>
<td>&quot;ETFs, Arbitrage, and Shock Propagation&quot;</td>
<td>U.S. equities 1998-2011</td>
<td>&quot;[O]ur results also provide support for the claim that high-frequency trading has the potential to rapidly propagate liquidity shocks across markets.&quot;; &quot;As much of ETF arbitrage is carried out at high frequencies, the evidence in the paper seems to suggest that HFT adds to the non-fundamental volatility of asset prices, at the very least. In more extreme situations, such as the Flash Crash, HFT can be highly destabilizing as it propagates shocks across markets at very high speed.&quot;</td>
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<td>Benos, Sagade</td>
<td>&quot;High-frequency trading behaviour and its impact on market quality: evidence from the UK equity market&quot;</td>
<td>U.K. equities, 2011 or 2012</td>
<td>&quot;It thus appears that the more HFTs trade aggressively the more they contribute to both price discovery and excess volatility.&quot;</td>
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<td>Benos, Weatherilt</td>
<td>&quot;The role of designated market makers in the new trading landscape&quot;</td>
<td>U.K. equities</td>
<td>&quot;Moreover, the de facto high-frequency market makers that have entered markets following technological advances are free to enter or exit the market at will. This allows them to compete with DMMs when market-making is profitable but withdraw altogether from the market when it is not, leaving DMMs to bear the brunt of market-making obligations in a stressed market.&quot;</td>
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<td>Biais, Foucault</td>
<td>&quot;HFT and Market Quality&quot;</td>
<td>Research literature review</td>
<td>&quot;[W]e recommend developing trading mechanisms that cater specifically to slow traders. This could require regulatory intervention to overcome exchanges' conflict of interests. We also recommend imposing minimum capital requirements for HFT firms. Moreover we emphasize the need for stress tests to evaluate the robustness of the market to technological problems or high-frequency firms' failure, and for pilot experiments, to assess and fine tune trading rules designed to slow the trading process.&quot;</td>
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<tr>
<td>Bichetti, Maystre</td>
<td>&quot;The synchronized and long-&quot;</td>
<td>U.S. futures and equities, 1997-2011</td>
<td>&quot;This paper documented striking similarities in the evolution of the rolling correlations&quot;</td>
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<td>Lasting structural change on commodity markets: evidence from high frequency data* (2012)</td>
<td>United Nations</td>
<td>between the returns on several commodity futures and the ones on the US stock market, computed at high frequencies...we think that HFT strategies, in particular the trend-following ones, are playing a key role...commodity markets are more and more prone to events in global financial markets and likely to deviate from their fundamentals.&quot;</td>
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<tr>
<td>Boehmer, Fong, Wu, &quot;International Evidence on Algorithmic Trading&quot; (2012)</td>
<td>Singapore Management University</td>
<td>&quot;Overall, our results show that algorithmic trading often improves liquidity, but this effect is smaller when market making is difficult and for low-priced or high-volatility stocks. It reverses for small cap stocks, where AT is associated with a decrease in liquidity. AT usually improves efficiency. The main costs associated with AT appear to be elevated levels of volatility. This effect prevails even for large market cap, high price, or low volatility stocks, but it is more pronounced in smaller, low price, or high volatility stocks.&quot;</td>
<td></td>
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<tr>
<td>Boehmer, Fong, Wu, &quot;Algorithmic Trading and Changes in Firms' Equity Capital&quot; (2012)</td>
<td>Singapore Management University</td>
<td>&quot;Our findings suggest that the activity of algorithmic traders can have impact beyond the immediate trading environment and potentially affect the more fundamental functions of capital markets, such as the allocation of capital to firms.&quot;; &quot;We find that greater AT intensity is, on average, associated with declines in equity capital in the next year. This result is only partly driven by a decline in new securities issues; rather, greater AT intensity is associated with an increase in repurchase activity. These results control for market capitalization, book-to-market, volatility, liquidity, and information asymmetry at the firm level, and for secular trends at the market level...&quot;</td>
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<tr>
<td>Boni, Brown, Leach, &quot;Dark Pool Exclusivity Matters&quot; (2012)</td>
<td>University of New Mexico</td>
<td>Excluding HFT from a market center results in lower volatility, less front-running, and higher execution quality for institutional traders.</td>
<td></td>
</tr>
<tr>
<td>Boulton, Braga-Alves, Kulchania, &quot;The Flash Crash: Effects on Shareholder Wealth and Market Quality&quot; (2012)</td>
<td>Miami University</td>
<td>&quot;We show that the flash crash was not just a 20 minute glitch as it has been described in [the] popular press. Overall, the flash crash is a significant event that affected shareholder wealth, trading costs, and volatility of stocks.&quot;; &quot;Our results suggest that seemingly fleeting events, such as the flash crash, can have dramatic and lingering effects on shareholder wealth and market quality.&quot;</td>
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<tr>
<td>Breckenfelder, &quot;Competition between High-Frequency Market Makers, and Market Quality&quot; (2013)</td>
<td>Swedish equities, 2009</td>
<td>Examines the introduction of HFT to the Swedish market; finds evidence of HFT herding, where HFT firms take the same side of the market and increase volatility; slower traders exit the market, decreasing participant...</td>
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<tr>
<td>Source</td>
<td>Location</td>
<td>Period</td>
<td>Findings</td>
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<tr>
<td>European Central Bank</td>
<td>Diversity</td>
<td>European Central Bank</td>
<td>&quot;Our findings suggest unequivocally mixed results regarding market quality. First, intraday volatility increases severely by an average of over 25%, five-minute volatility 15% and maximum intraday volatility 15%.&quot;</td>
</tr>
<tr>
<td>Brogaard, Hendershott, Hunt, Latza, Pedace, Ysusi, &quot;High-frequency trading and the execution costs of institutional investors&quot; (2012)</td>
<td>U.K. equities, 2007-2011</td>
<td>HFT firms maintain they lower costs for traditional investors. This study notes that while investor costs have gone down in recent years, HFT firms don't account for those lower costs. &quot;We show that in the UK, like in the US, there has broadly been a decrease in institutional execution costs over the last decade...[but] we fail to observe a relationship between HFT and institutional execution costs.&quot;</td>
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<tr>
<td>Budish, Cramton, Shim, &quot;The High-Frequency Trading Arms Race: Frequent Batch Auctions as a Market Design Response&quot; (2013)</td>
<td>U.S. futures and equities, 2005-2011</td>
<td>&quot;[W]e show that the [HFT speed] arms race is socially wasteful – a prisoner’s dilemma built directly into the market design – and that its cost is ultimately borne by fundamental investors via wider spreads and thinner markets.&quot; See also &quot;The Big Question: Are high frequency traders ruining the market?&quot;</td>
<td></td>
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<tr>
<td>CBOT, CBOT-13-9358-BC</td>
<td>U.S. futures, 2012</td>
<td>&quot;Panel found that on December 14, 2012, Credit Suisse operated an automated trading system (ATS) that malfunctioned and caused an excessive number of orders and cancel messages to be entered in the March 2013 Two-Year futures contract on the Globex electronic trading platform. Although Credit Suisse became aware of the malfunction immediately, it allowed the ATS to continue to operate for 90 minutes while attempting to identify the cause and rectify the problem. During those 90 minutes, the ATS accounted for 88% of the messaging volume in the contract. Credit Suisse ultimately deactivated the ATS only after the Exchange contacted the firm regarding the messaging activity.&quot;</td>
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<tr>
<td>CFA Institute, &quot;Dark Pools, Internalization, and Equity Market Quality&quot; (2012)</td>
<td>U.S. equities, 2009-2011</td>
<td>&quot;The results from this study suggest that if a majority of trading in a given stock takes place in undisplayed venues, spreads will likely increase and market quality will deteriorate. If the majority of order flow is filled away from pre-trade transparent markets, investors could withdraw quotes because of the reduced likelihood of those orders being filled. As investors become disincentivized from displaying orders, bid–offer spreads are likely to widen. Therefore, competition should be maintained to encourage aggressive quoting in displayed order books and a predominance of dark trading should be avoided.&quot;</td>
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<td>Author(s)</td>
<td>Paper Title</td>
<td>Year</td>
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<tr>
<td>Chae, Wang</td>
<td>&quot;Determinants of Trading Profits: The Liquidity Provision Decision&quot;</td>
<td>2009</td>
<td>Seoul National University</td>
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<tr>
<td>Chakrabarty, Jain, Shkilko, Sokolov</td>
<td>&quot;Speed of market access and market quality: Evidence from the SEC naked access ban&quot;</td>
<td>2014</td>
<td>St. Louis University</td>
</tr>
<tr>
<td>China Securities Regulatory Commission</td>
<td>&quot;Investigation and Penalties Regarding the Abnormal Trading of Everbright Securities&quot;</td>
<td>2013</td>
<td>Trading firm Chinese equities data and trading firm procedures</td>
</tr>
<tr>
<td>Chung, Chuwonganant</td>
<td>&quot;Uncertainty, Fear, and Liquidity&quot;</td>
<td>2012</td>
<td>State University of New York</td>
</tr>
<tr>
<td>Clark-Joseph</td>
<td>&quot;Exploratory Trading&quot;</td>
<td>2013</td>
<td>Harvard University</td>
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Note that access to this paper has been restricted. See "The Influence of the For Profit..."
<table>
<thead>
<tr>
<th>Source</th>
<th>Year/Description</th>
<th>Evidence</th>
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<tbody>
<tr>
<td>Convergex, <em>U.S. Equity Market Structure Survey</em> (2014)</td>
<td>Survey of U.S. market participants</td>
<td>&quot;Our survey found that a majority of financial industry participants believe that the U.S. equity markets are unfair and that HFT is harmful.&quot;</td>
</tr>
<tr>
<td>Convergex, <em>European Equity Market Structure Survey</em> (2014)</td>
<td>Survey of European market participants</td>
<td>39% of survey respondents believed HFT was harmful or very harmful to market participants.</td>
</tr>
<tr>
<td>Dichev, Huang, Zhou, <em>The Dark Side of Trading</em> (2011)</td>
<td>U.S. equities, 1926-2009</td>
<td>&quot;Our main finding is that, controlling for other factors, there is a reliable and economically substantial positive relation between volume of trading and stock volatility. The conclusion is that stock trading produces its own volatility above and beyond that based on fundamentals...&quot;; &quot;The combined impression from these results is that stock trading injects an economically substantial layer of volatility above and beyond that based on fundamentals, especially at high levels of trading.&quot;</td>
</tr>
<tr>
<td>Ding, Hanna, Hendershott, <em>How Slow is the NBBO? A Comparison with Direct Exchange Feeds</em> (2013)</td>
<td>U.S. equities, 2012</td>
<td>&quot;While price dislocations have small effects on infrequently trading investors, investors that are continuously in the market can be substantially disadvantaged.&quot;</td>
</tr>
<tr>
<td>Direct Edge, <em>Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Offer and Establish Fees for a New Exchange Service, EdgeRisk Gateways</em> (2013)</td>
<td>U.S. equities</td>
<td>The EDGX Exchange, a subsidiary of Direct Edge, submitted an extraordinary filing to the SEC proposing a facility that would protect its customers from manipulative quote stuffing strategies. Fees for the service started at $5,000/month. &quot;In providing access to a pair of access gateways, the Service is also designed to allow Subscribers to mitigate risks associated with potentially fraudulent and manipulative acts and practices that may adversely affect the Subscriber’s trading experience. If, for example, a firm attempted to manipulate the submission of order flow into shared access gateways by directly or indirectly causing a surge in message traffic to be sent to the Exchange, Subscribers would, to an extent, mitigate the risks associated with such a...&quot;</td>
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Themis Trading *wrote about the service* on November 14, 2014, "Rather than try and identify the quote stuffing culprit, exchanges have figured out a way to profit from this illegal activity." EDGX filed to discontinue it on December 5, 2014.

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<tr>
<th>Author(s)</th>
<th>Location</th>
<th>Time Period</th>
<th>Description</th>
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<tr>
<td>Easley, Lopez del Prado, O'Hara</td>
<td>U.S. futures, 2010</td>
<td>Unregulated or unconstrained HFT market makers can exacerbate price volatility when they dump inventory and withdraw, flash crashes will recur because of structural issues.</td>
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<tr>
<td>Egginton, Van Ness, Van Ness</td>
<td>U.S. equities, 2010</td>
<td>&quot;We find that quote stuffing is pervasive with several hundred events occurring each trading day and that quote stuffing impacts over 74% of US listed equities during our sample period. Our results show that, in periods of intense quoting activity, stocks experience decreased liquidity, higher trading costs, and increased short-term volatility. Our results suggest that the HFT strategy of quote stuffing may exhibit some features that are criticized in the media.&quot;</td>
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<tr>
<td>Egginton, Van Ness, Van Ness</td>
<td>U.S. equities, 2007 and 2010</td>
<td>&quot;Taken together, our results suggest that restrictions on stub quoting, which increase dealers' obligations to quote near the NBBO, may benefit financial markets in that it encourages dealers to provide liquidity.&quot;</td>
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<td>Ferguson, Mann</td>
<td>U.S. futures, 1992</td>
<td>Unregulated or unconstrained market makers in the futures market have much more rapid inventory cycles than (regulated) equity market makers, are active rather than passive traders, and &quot;actively trade for their own accounts, profiting from their privileged access...&quot;</td>
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<td>Filimonov, Bicchetti, Maystre, Sornette</td>
<td>U.S. and European futures, 1998-2012</td>
<td>&quot;For all analyzed markets, we have found high levels of endogeneity. On average, our conservative estimates show that more than one out of two price changes is due to another preceding price change since the second-half of the 2000s, and not due to an exogenous piece of news. In other words, price dynamics on these commodity markets are partly driven by self-reinforcing mechanisms. In our view, this evolution partly reflects the development of algorithmic trading and of high frequency trading in particular.&quot;</td>
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<td>FINRA</td>
<td>U.S. data and broker firm procedures, 2008-2011</td>
<td>&quot;During the period of January 2008 through December 2011 (the 'relevant period'), the Firm failed to establish, maintain and enforce adequate supervisory systems and...&quot;</td>
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<td>Source</td>
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<td>FINRA, &quot;Financial Industry Regulatory Authority Letter of Acceptance, Waiver and Consent No.2010022334505&quot; (2014)</td>
<td>U.S. equities, 2010-2013</td>
<td>&quot;This matter involves CDRG's failure to reasonably prevent the transmission of erroneous orders to Nasdaq, BATS Exchange, Inc. (BZX), BATS Y-Exchange, Inc. (&quot;BYX&quot;), and NYSE Arca, Inc. (&quot;NYSE Arca&quot;) (the 'exchanges') during the period March 18, 2010 through January 8, 2013 (review period).&quot;</td>
<td></td>
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</tbody>
</table>
| FINRA, "FINRA Charges Wedbush Securities for Systemic Market Access Violations, Anti-Money Laundering and Supervisory Deficiencies" (2014) | U.S. data and broker firm procedures, 2008-2013                    | "The complaint alleges that from January 2008 through August 2013, Wedbush failed to dedicate sufficient resources to ensure appropriate risk management controls and supervisory systems and procedures. This enabled its market access customers to flood U.S. exchanges with thousands of potentially manipulative wash trades and other potentially manipulative trades, including manipulative layering and spoofing."
From the complaint:
"During the relevant period, Wedbush executed for market access customers over 100,000 instances of potential layering, spoofing and auto-execution manipulation, executed in multiple securities across the Exchanges. Wedbush's high-volume, high-frequency trading customers employed aggressive, potentially destabilizing trading strategies in illiquid securities." |
<p>| Frino, Forrest, Duffy, &quot;Life in the pits; competitive market making and inventory control-further Australian evidence&quot; (1999) | Australian futures, 1997                                            | Unregulated or unconstrained market makers are not passive liquidity providers, they behave aggressively like informed traders. |
| University of Sydney                                                |                                                                     |                                                                                                                                       |
| Frino, Jarnecic, &quot;An empirical analysis of the supply of liquidity by locals in futures markets: Evidence from the Sydney Futures Exchange&quot; (2000) | Australian futures, 1997                                            | Unregulated or unconstrained market makers demand liquidity to profit from information advantages of privileged access, less likely to supply liquidity in volatile markets, almost as likely to demand as to supply liquidity. |</p>
<table>
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<tr>
<th>Institution</th>
<th>Title</th>
<th>Publication Year</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>University of Sydney</td>
<td>Frino, Jar necic, Feletto, <em>Local Trader Profitability in Futures Markets: Liquidity and Position Taking Profits</em> (2009)</td>
<td></td>
<td>Unregulated or unconstrained market makers are active and informed traders.</td>
</tr>
<tr>
<td>University of Sydney</td>
<td>Gao, Mizrach, <em>High Frequency Trading in the Equity Markets During U.S. Treasury POMO</em> (2013)</td>
<td></td>
<td>&quot;While HFT firms are generally deemed to be passive liquidity providers, we find that they act as trade initiators in nearly 47% of trades in normal times. High frequency traders appear to have superior information. Whether they are at the active or passive side, the trades are more profitable when the counterpart is a non-HFT firm rather than a HFT firm. The 'Flash Crash' helps to clarify why reporting the average effect of HFT firms on the market may provide a misleading portrait of their contribution to market quality. Analyzing their impact when the market is under stress or reacting to news needs to be isolated from their contribution during less turbulent periods.&quot;</td>
</tr>
<tr>
<td>Rutgers University</td>
<td>Gerig, <em>High-Frequency Trading Synchronizes Prices in Financial Markets</em> (2015)</td>
<td></td>
<td>&quot;Policy makers across the globe are spending considerable effort deciding if and how to regulate HFT. On the one hand, HFT appears to make markets more efficient. Algorithmic trading in general, and HFT specifically, increases the accuracy of prices and lowers transaction costs. On the other hand, HFT appears to make the financial system as a whole more fragile. The rapid fall and subsequent rise in prices that occurred in US markets on May 6, 2010 (known as the 'Flash Crash'), was, in part, due to HFT....during times of market stress, HFT firms are impelled to leave the market if their systems observe events outside the parameters they are programmed to handle - a circumstance that causes liquidity to disappear at the precise time it is needed the most.&quot;</td>
</tr>
<tr>
<td>Manchester Business School</td>
<td>Golub, Keane, <em>Mini Flash Crashes</em> (2011)</td>
<td></td>
<td>&quot;As soon as the [HFT] market maker's risk management limits are breached...the market maker has to stop providing liquidity and start to aggressively take liquidity, by selling back the shares bought moments earlier. This way they push the price further down and thus exaggerate the downward movement.&quot;</td>
</tr>
<tr>
<td>Manchester Business School</td>
<td>Golub, Keane, Poon, <em>High Frequency Trading and Mini Flash Crashes</em> (2012)</td>
<td></td>
<td>&quot;We find strong evidence that Mini Flash Crashes have an adverse impact on market liquidity and are associated with Fleeting Liquidity.&quot;; &quot;Given the speed and the magnitude of the crashes, it appears likely that...&quot;</td>
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<tr>
<td>Source</td>
<td>Data/Methodology</td>
<td>Summary</td>
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<td>Government Office for Science, <em>Foresight: The Future of Computer Trading in Financial Markets, Final Project Report: Executive Summary</em> (2012)</td>
<td>Varied data; literature reviews</td>
<td>&quot;A key message: despite commonly held negative perceptions, the available evidence indicates that high frequency trading (HFT) and algorithmic trading (AT) may have several beneficial effects on markets. However, HFT/AT may cause instabilities in financial markets in specific circumstances.&quot;</td>
<td></td>
</tr>
<tr>
<td>Hasbrouck, &quot;High frequency quoting; Short-term volatility in bids and offers&quot;, (2015) New York University</td>
<td>U.S. equities, 2001-2011</td>
<td>&quot;As defined and estimated here, quote volatility reflects both fundamental and transient volatility. These two components are not resolved, but variance ratios can be used to infer their relative magnitudes. These estimates suggest that at sub-second time scales, variance is generally more than double the level that would be implied by a relatively long-term (twenty-minute) variance that is presumably more fundamental.&quot;</td>
<td></td>
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<tr>
<td>Hautsch, Huang, <em>On the Dark Side of the Market: Identifying and Analyzing Hidden Order Placements</em> (2012) University of Vienna</td>
<td>U.S. equities, 2010</td>
<td>A frequent criticism of the proprietary data feeds exchanges sell to HFT firms is that the feeds reveal information investors reasonably believe is confidential; &quot;Using data from the NASDAQ TotalView message stream allows us to retrieve information on hidden depth from one of the largest equity markets in the world.&quot;</td>
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<tr>
<td>Hirschey, <em>Do High-Frequency Traders Anticipate Buying and Selling Pressure?</em> (2013) London Business School</td>
<td>U.S. equities, 2009</td>
<td>&quot;I find evidence consistent with HFTs being able to anticipate order flow from other investors.&quot;; &quot;These findings provide evidence supporting the existence of an anticipatory trading channel through which HFTs may increase non-HFT trading costs.&quot;</td>
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<tr>
<td>Hong Kong Securities and Futures Commission, &quot;SFC reprimands and fines IMC Asia Pacific Limited [HK$1.5 Million]&quot; (2012)</td>
<td>Trading firm Hong Kong data and trading firm controls, 2007-2010</td>
<td>&quot;IMC's failures spanned a period of over three years during a time of substantial market volatility when short selling controls were high on the regulatory agenda. IMC's negligent controls were well below the standards expected in Hong Kong. Market participants should be aware that short selling is tightly regulated in Hong Kong and any breaches of the rules will be strictly enforced;' the SFC's Executive Director of Enforcement, Mr Mark Steward said.&quot;</td>
<td></td>
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</tbody>
</table>
| Huh, "Machines vs. Machines: High Frequency Trading and Hard Information" (2014) | U.S. equities, 2008 | "A major concern about HFTs replacing traditional market makers is that since HFTs do not have market making obligations, they might leave the market when market makers are needed the most. Although my sample
period does not cover certain extreme events such as the 2010 Flash Crash (the market turmoil in 2008 is arguably quite extreme as well, albeit in a different way), I do document that the market-making HFTs provide less liquidity replenishment when markets are volatile.

Johnson, Zhao, Hunsader, Qi, Johnson, Meng, Tivnan, "Abrupt rise of new machine ecology beyond human response time" (2013) University of Miami

"In this paper we carry out a study of ultrafast extreme events (UEEs) in financial market stock prices. Our study is inspired by the seminal works of Farmer, Preis, Stanley, Easley and Cliff and co-workers who stressed the need to understand ultrafast market dynamics. To carry out this research, we assembled a high-throughput millisecond-resolution price stream across multiple stocks and exchanges using the NANEX NxCore software package. We uncovered an explosion of UEEs starting in 2006, just after new legislation came into force that made high frequency trading more attractive. Specifically, our resulting dataset comprises 18,520 UEEs (January 3rd 2006 to February 3rd 2011) which are also shown visually on the NANEX website at www.nanex.net."


"In the present environment, where high frequency and algorithmic trading predominate and where exchange competition has essentially eliminated rule-based market maker obligations, liquidity problems are an inherent difficulty that must be addressed. Indeed, even in the absence of extraordinary market events, limit order books can quickly empty and prices can crash simply due to the speed and numbers of orders flowing into the market and due to the ability to instantly cancel orders."

Jørgensen, Skjeltorp, Ødegaard, "Throttling Hyperactive Robots - Message to Trade Ratios on the Oslo Stock Exchange" (2014) BI Norwegian Business School

"We use the introduction of a cost on high message to trade ratios for traders at the Oslo Stock Exchange to investigate the effects on market quality and fragmentation of introduction of such 'speed bumps' to equity trading. The exchange introduced a fee payable by market participants whose orders (messages to the exchange’s trade system) exceeded seventy times the number of consummated trades. Market participants quickly adjusted their behavior to avoid paying the extra cost. The overall ratios of messages to trades fell, but common measures of the quality of trading, such as liquidity, transaction costs, and realized volatility, did not deteriorate, they were essentially unchanged."

Kang, Shin, "The Role of High Frequency Traders in Korea futures, 2007

"We find that when high frequency traders make use of fleeting orders actively, the level
<table>
<thead>
<tr>
<th>Title</th>
<th>Author(s)</th>
<th>Year</th>
<th>Key Findings</th>
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<tbody>
<tr>
<td>Electronic Limit Order Markets” (2012)</td>
<td>KAIST (Korea Advanced Institute of</td>
<td>March 2015</td>
<td>of informativeness in the limit order book declines. This evidence suggests, albeit indirectly, that massive use of limit orders including revision and cancellation by high frequency traders may potentially have negative effects on the market.”</td>
</tr>
<tr>
<td>Kim, Murphy, “The Impact of High-Frequency Trading on Stock Market</td>
<td>Northwestern University</td>
<td>2013</td>
<td>Traditional market microstructure models have significantly underestimated market spreads in recent years. This is because of how trade sizes have decreased with the recent dominance of high frequency trading. When the authors correct for this they find that spreads have not decreased as much as HFT proponents believe.</td>
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<tr>
<td>Research literature review</td>
<td></td>
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<td>“[I]ncreased high-frequency trading may not necessarily be associated with improved liquidity.”</td>
</tr>
<tr>
<td>Kirilenko, Lo, “Moore’s Law vs. Murphy’s Law: Algorithmic Trading and</td>
<td>Massachusetts Institute of</td>
<td>2013</td>
<td>“In contrast to a number of public claims, high frequency traders do not as a rule engage in the provision of liquidity like traditional market makers. In fact, those that do not provide liquidity are the most profitable and their profits increase with the degree of ‘aggressive,’ liquidity-taking activity.”</td>
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<tr>
<td>Research literature review</td>
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<td>Unregulated or unconstrained HFT market makers exacerbated price volatility in the Flash Crash, hot potato trading, two minute market maker inventory half-life; “These results are inconsistent with the notion that High Frequency Traders behave like textbook market makers, suffering adverse selection losses associated with being picked off by informed traders. Instead, when the price is about to move to a new level, HFTs tend to avoid being run over and take the price to the new level with Aggressive trades of their own....At times of market stress, when prices are moving directionally, due to an order flow imbalance and the volatility is already elevated, this trading activity can amplify a directional price move and significantly add to volatility.”</td>
</tr>
<tr>
<td>Kirilenko, Samadi, Kyle, Tuzun, “The Flash Crash: The Impact of High</td>
<td>Massachusetts Institute of</td>
<td>2014</td>
<td>Unregulated or unconstrained market makers demand liquidity to profit from information advantages of privileged access.</td>
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<td>Research literature review</td>
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<td>Kurov, Lasser, “Price Dynamics in the Regular and E-Mini Futures</td>
<td>State University of New York</td>
<td>2004</td>
<td>“We find that high frequency traders (HFTs) do not provide liquidity in the futures market, nor</td>
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<tr>
<td>Lee, “High Frequency Trading in the Korean”</td>
<td>Korean futures, 2009-2010</td>
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<td>Reference</td>
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<tr>
<td>Index Futures Market” (2013)</td>
<td>Hanyang University</td>
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<td>does HFT have any role in enhancing market quality. Indeed, HFT is detrimental to the price discovery process.&quot;</td>
</tr>
<tr>
<td>Linton, O'Hara, “The impact of computer trading on liquidity, price efficiency/discovery and transaction costs” (2011)</td>
<td>Cambridge University</td>
<td>Research literature review</td>
<td>&quot;The nature of market making has changed, shifting from designated providers to opportunistic traders. High frequency traders now provide the bulk of liquidity, but their use of limited capital combined with ultra-fast speed creates the potential for periodic illiquidity&quot;: in &quot;regular market conditions,&quot; liquidity has improved and transaction costs are lower.</td>
</tr>
<tr>
<td>Locke, Sarajoti, &quot;Interdealer Trading in Futures Markets” (2001)</td>
<td>Texas Christian University</td>
<td>U.S. futures, 1995</td>
<td>Unregulated or unconstrained market makers demand liquidity to manage inventories.</td>
</tr>
<tr>
<td>Lyons, &quot;Foreign exchange volume: Sound and fury signifying nothing?” (1996)</td>
<td>University of California</td>
<td>U.S. foreign exchange, 1992</td>
<td>Unregulated or unconstrained market makers cascade inventory imbalances from one to another, as &quot;...trading begets trading. The trading begotten is relatively uninformative, arising from repeated passage of inventory imbalances among dealers...this could not arise under a specialist [regulated market maker] microstructure.&quot;</td>
</tr>
<tr>
<td>Machain, Dufour, “The Price Impact of Limit Order Cancellations” (2013)</td>
<td>University of Reading</td>
<td>U.K. equities</td>
<td>“[P]olicy makers have recently suggested the introduction of a minimum period of time a limit order should be kept on the order book to avoid speculative practices. In this paper, we provide empirical evidence supporting that.”</td>
</tr>
<tr>
<td>MacKenzie, &quot;A Sociology of Algorithms: High Frequency Trading and the Shaping of Markets” (2014)</td>
<td>HFT practitioner interviews</td>
<td></td>
<td>“Unexpected behavior by trading algorithms has led to well publicized disasters, such as the $440 million loss incurred in 45 minutes by Knight Capital on August 1, 2012 when an old, forgotten algorithm mistakenly left on one of...”</td>
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</table>

See also Kirilenko, Samadi, Kyle, Tuzun, "The Flash Crash: The Impact of High Frequency Trading on an Electronic Market".
<table>
<thead>
<tr>
<th>University of Edinburgh</th>
<th>Knight’s trading servers suddenly sprung to life. Indeed, human users of algorithms may not always accurately understand even their routine behavior:</th>
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<td>[S]omeone could be in all honesty saying [their algorithms are] doing [something] when in fact they are doing something else: they’re just not measuring it right. (Interviewee AP)”</td>
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</table>

| Madhavan, “Exchange-Traded Funds, Market Structure and the Flash Crash” (2011) | U.S. equities, 1994-2011 | “We show that the impact of the Flash Crash across stocks is systematically related to prior market fragmentation.”; “Using intraday trade data from January 1994-September 2011, we find that fragmentation now is at the highest level recorded.”; “The link to higher frequency quotation activity and the current high levels of fragmentation help explain why a Flash Crash did not occur before and offers a counterpoint to the view that the Flash Crash stemmed from an unlikely confluence of events.” |

| Blackrock | University of Utah | “Be Grateful for Drizzle” |

| Manaster, Mann, “Life in the pits: competitive market making and inventory control” (1996) | U.S. futures, 1992 | Unregulated or unconstrained market makers aggressively manage inventory, are “active profit-seeking.” have much shorter inventory cycles than then-regulated equities market makers. |


| McInish, Upson “Strategic Liquidity Supply in a Market with Fast and Slow Traders” (2012) | U.S. equities, 2008 | “We model and show empirically that latency differences allow fast liquidity suppliers to pick off slow liquidity demanders at prices inferior to the NBBO. This trading strategy is highly profitable for the fast traders.”; “[O]ur research focuses on the ability of fast liquidity suppliers to use their speed advantage to the detriment of slow liquidity demanders, which we believe unambiguously lowers market quality. The ability of fast traders to take advantage of slow traders is exacerbated in the U.S. by the regulatory and market environment that we describe below.” |

<p>| Menkveld, Yueshen, “The Flash Crash: A Cautionary Tale about Highly Fragmented Markets” (2015) | U.S. futures and equities, 2010 | An independent study confirming Kirilenko's findings that high frequency traders exacerbated volatility and caused significant price declines in the Flash Crash; “There is widespread concern that Flash Crash type events are the result of vulnerable electronic markets....the costs arising from broken |</p>
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<th>Source</th>
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<tr>
<td>VU University Amsterdam</td>
<td>Markets are borne by end-users of securities markets. The Flash Crash was by no means unique. Similar crashes hit the German DAX index (August 18, 2011 and April 17, 2013), the oil price (May 5, 2011), India’s National Stock Exchange index (October 5, 2012), the Anadarko stock (May 20, 2013), and the Procter and Gamble stock (August 30, 2013).&quot;</td>
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<td>Menkveld, Zoican, &quot;Need for Speed? Exchange Latency and Liquidity&quot; (2014)</td>
<td>Danish, Swedish, and Finnish equities, 2009-2010</td>
<td>&quot;The paper’s findings contribute to the public debate on electronic markets and, in particular, the role of speed in the trading process. It adds the insight that a faster market implies more interaction among HFTs, i.e., their market participation increases and, more importantly, transaction cost for 'low frequency' investors increases as a result.&quot;</td>
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<tr>
<td>Nanex, &quot;Perfect Pilfering&quot; (2014)</td>
<td>U.S. equities, 2014.</td>
<td>&quot;The chart on the right clearly shows that order cancellations happen far faster than trade executions (red line goes up faster than blue line). This is why our trader wasn’t able to get the advertised liquidity - those sell orders simply disappeared before the exchanges processed his buy order.&quot;</td>
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<td>Nasdaq, &quot;Notice of Acceptance of Letter of Acceptance, Waiver and Consent No. 20100214899-02&quot; (2013)</td>
<td>Trading firm U.S. data and trading firm procedures, 2009-2011.</td>
<td>&quot;During the review period, IMCC failed to establish and maintain adequate supervisory procedures, and a reasonable system of follow-up and review, related to the oversight of the firm’s high frequency and algorithmic trading, including procedures related to the review of wash sales, levels of message traffic and quotes, potentially erroneous trading activity, or the filing of Clearly Erroneous Execution (‘CEE’) petitions.&quot;</td>
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| Nasdaq, "Notice of Acceptance of Letter of Acceptance, Waiver and Consent No. 20100242271-01" (2012) | Trading firm U.S. data and trading firm procedures, 2010-2011. | "During the review period, the firm failed to establish and maintain a reasonable supervisory system, including but not limited to its written supervisory procedures and supervisory and operational risk controls systems related to the oversight and operation of the firm's high frequency and algorithmic trading."

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High Frequency Trading, a bibliography of evidence-based research March 2015
<table>
<thead>
<tr>
<th>Source</th>
<th>Scope</th>
<th>Evidence Type</th>
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<tr>
<td>Nasdaq, “Self-Regulatory Organizations: The NASDAQ Stock Market LLC: Notice of Filing of Proposed Rules Change to Amend Rule 4758(a)(1)(A) to Reflect a Change in Nasdaq's Routing Functionality” (2012)</td>
<td>U.S. equities</td>
<td>A remarkable statement by an exchange that quotes posted on US exchanges are often fleeting and inaccessible, resulting in inferior prices for investors; &quot;NASDAQ has observed that upon partial execution of a routable order at NASDAQ...market participants often react to the order by cancelling their orders on other markets and entering new orders at inferior prices. This occurs because the current process directs the order to NASDAQ before attempting to access available liquidity at other markets and thereby allows market participants to react to the execution (an effect known as 'market impact' or 'information leakage'). As a consequence, the available shares at the away market are no longer available, resulting in a lower likelihood of successfully accessing liquidity on away markets (i.e., the 'fill rate') and an increased likelihood of ultimately receiving an execution at an inferior price.&quot;</td>
</tr>
<tr>
<td>Norges Bank Investment Management, “High Frequency Trading - An Asset Manager’s Perspective” (2013)</td>
<td>Research literature review</td>
<td>With nearly $1 trillion under management, NBIM is the world’s largest sovereign wealth fund. &quot;In our view, issues of concern to large, long-term investors more deserving of attention include — Anticipation of large orders by some HFTs leading to potential adverse market impact — Transient liquidity due to high propensity for HFTs to rapidly cancel quotes real-time — Un-level playing field amongst market makers from low latency ultra HFT strategies.&quot;</td>
</tr>
<tr>
<td>NYSE Arca, “Proceeding No. 20110304774” (2014)</td>
<td>U.S. equities, 2010-2013</td>
<td>&quot;Violated NYSE Arca Equities Rule 7.23, by failing to maintain continuous, two-sided trading interest in approximately 20,000 instances; and violated NYSE Arca Equities Rules 6.18(b) and (c), by failing to reasonably supervise the activities of its associated persons and the operation of its business in that it failed to establish and maintain adequate supervisory procedures, including written procedures, and a reasonable system of follow-up and review, reasonably designed to ensure compliance with NYSE Arca Equities Rule 7.23.&quot;</td>
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<tr>
<td>NYSE, “The New York Stock Exchange LLC Letter”</td>
<td>U.S. equities, 2010-2013</td>
<td>&quot;During the Relevant Period, several million SLP orders the firm entered through its SLP ...&quot;</td>
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<td>Panayides, “Affirmative obligations and market making with inventory”</td>
<td>U.S. equities, 1991 and 2001</td>
<td>Mandatory market maker obligations reduce volatility.</td>
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<td>University of Utah</td>
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<td>Pragma Securities, &quot;HFT and the Hidden Cost of Deep Liquidity&quot; (2012)</td>
<td>US equities, 2011 and 2012</td>
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<td>Principal Global Investors, “Investing in a High-Frequency Trading Environment” (2014)</td>
<td>Survey of asset managers in 30 countries with $6 trillion under management.</td>
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<td>Quantitative Services Group, “Liquidity Change and Price Reversals: Is High Frequency Trading Adding Insult to Injury?” (2010)</td>
<td>U.S. equities, 2008-2009</td>
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<tr>
<td>Raman, Robe, Yadav, &quot;Electronic Market Makers, Trader Anonymity and Market Fragility&quot; (2014)</td>
<td>U.S. futures, 2006, 2008, 2011</td>
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<td>University of Warwick</td>
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High Frequency Trading, a bibliography of evidence-based research
March 2015
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<tr>
<th>Author(s)</th>
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<tbody>
<tr>
<td>Rogers, Skinner, Zechman</td>
<td>&quot;Run Edgar Run: SEC Dissemination in a High-Frequency World&quot;</td>
<td>U.S. SEC filings, 2012-2013</td>
<td>&quot;[W]e also show that Tier 1 PDS subscribers, who pay for direct access to EDGAR, usually receive filings before they are available on the SEC website....The average timing advantage is about 10 seconds, a relatively long time in the world of high frequency trading. Moreover, we report clear evidence - from prices, trading volume, and spreads - that certain market participants appear to trade on the news in advance of its public release. We find that all three measures of market activity begin to move up to 30 seconds before the filing is made available on the SEC site. This is hard to reconcile with the notion that the EDGAR process provides a level playing field to investors.&quot;</td>
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<tr>
<td>Schroder Investment Management Limited</td>
<td>&quot;High frequency trading: Credible research tells the story&quot;</td>
<td>Research literature review</td>
<td>&quot;As standards in research continue to improve, simple default commentary such as HFT are 'liquidity providers,' HFT 'dampens volatility' and HFT 'decreases bid-ask spreads' have suffered something of a credibility anorexia despite their continued use by some.&quot;</td>
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<tr>
<td>Silber</td>
<td>&quot;Marketmaker Behavior in an Auction Market: An Analysis of Scalpers in Futures Markets&quot;</td>
<td>U.S. futures, 1982-1983</td>
<td>Unregulated or unconstrained market makers profit from the information advantages of privileged access, two minute inventory cycles.</td>
</tr>
<tr>
<td>Smidt</td>
<td>&quot;Trading Floor Practices on Futures and Securities Exchanges: Economics, Regulation, and Policy Issues&quot;</td>
<td>Research literature review</td>
<td>On futures exchanges, inventory imbalances among unregulated or unconstrained market makers create &quot;potentially unstable&quot; markets and price overreactions during &quot;scalper inventory liquidation.&quot;</td>
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<tr>
<td>Tong</td>
<td>&quot;A Blessing or a Curse? The Impact of High Frequency Trading on Institutional Investors&quot;</td>
<td>U.S. equities, 2008-2009</td>
<td>&quot;I find strong evidence that HFT increases the trading costs of institutional investors.&quot;</td>
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<tr>
<td>Toulson</td>
<td>&quot;Do HFTs really 'Game' buy-side orders&quot;</td>
<td>European equities, 2013</td>
<td>&quot;HFT liquidity providers, reacting to these trades, immediately cancelled most of the orders resting on XSTO....Other HFT market participants (not necessarily the same firms) aggressively traded 'in front' of the SOR slice....What does this example tell us? Firstly, significantly high and persistent bid ask spreads....our results raise the question of whether exchanges and regulators should consider affirmative obligations for hitherto voluntary market makers.&quot;</td>
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High Frequency Trading, a bibliography of evidence-based research

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<th>Author(s)</th>
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<tr>
<td>Tse, Lin, Vincent</td>
<td>&quot;High Frequency Trading - Measurement, Detection and Response&quot; (2012)</td>
<td>European equities, 2010-2012</td>
<td>&quot;We present a detailed study of a variety of negative HFT strategies - including examples of Quote Stuffing, Layering/Order Book Fade, and Momentum Ignition - to demonstrate what bad HFT 'looks like', how often it happens, and how we detect it.&quot; See also &quot;From High Frequency Trading To A Broken Market: A Primer In Two Parts&quot;.</td>
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<td>Turbeville</td>
<td>&quot;High Frequency Trading&quot; (2013)</td>
<td>Research literature review</td>
<td>&quot;[T]he illusion of market liquidity provided by HFT volume leads to the inherent instability of market pricing mechanisms. In addition, aggressive HFT tactics mislead market participants in terms fundamental price. Finally, Dark Pools, trading venues that exist because of HFTs, impair price discovery.&quot;</td>
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<td>United States Federal Reserve Bank of Chicago, Carol Clark</td>
<td>&quot;How to Keep Markets Safe in the Era of High-Speed Trading&quot; (2012)</td>
<td>Interviews and fieldwork with proprietary trading firms, including high frequency trading firms.</td>
<td>&quot;Another area of concern is that some firms do not have stringent processes for the development, testing, and deployment of code used in their trading algorithms. For example, a few trading firms interviewed said they deploy new trading strategies quickly by tweaking old code and placing it into production in a matter of minutes. In fact, one firm interviewed had two incidents of out-of-control algorithms. To address the first occurrence, the firm added additional pre-trade risk checks. The second out-of-control algorithm was caused by a software bug that was introduced as a result of someone fixing the error code that caused the first situation.&quot;</td>
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<tr>
<td>United States Federal Trade Commission</td>
<td>&quot;Report of the Federal Trade Commission on the Grain Trade,&quot; Volume 7 (1926)</td>
<td>U.S. futures, 1915-1922</td>
<td>Unregulated or unconstrained market makers both cause and exacerbate price volatility; &quot;The scalpers who operate with reference to fractional changes within the day may have a stabilizing effect on prices so far as such changes with the day are concerned, but when the market turns they run with it, and they may accentuate an upward or downward movement that is already considerable.&quot;</td>
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<td><strong>United States Securities and Exchange Commission, &quot;SEC Charges Knight Capital With Violations of Market Access Rule&quot; (2013)</strong></td>
<td><strong>Trading firm U.S. equities data and trading firm procedures, 2012.</strong></td>
<td>&quot;An SEC investigation found that Knight Capital did not have adequate safeguards in place to limit the risks posed by its access to the markets, and failed as a result to prevent the entry of millions of erroneous orders.&quot;</td>
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<td><strong>United States Securities and Exchange Commission, &quot;SEC Charges New York-Based High Frequency Trading Firm With Fraudulent Trading to Manipulate Closing Prices&quot; (2014)</strong></td>
<td><strong>U.S. equities, 2009</strong></td>
<td>&quot;The Securities and Exchange Commission today sanctioned a New York City-based high frequency trading firm for placing a large number of aggressive, rapid-fire trades in the final two seconds of almost every trading day during a six-month period to manipulate the closing prices of thousands of NASDAQ-listed stocks.&quot;</td>
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<tr>
<td><strong>United States Securities and Exchange Commission, &quot;SEC Charges Direct Edge Exchanges With Failing to Properly Describe Order Types&quot; (2015)</strong></td>
<td><strong>U.S. exchange rule filings, exchange communications</strong></td>
<td>&quot;These exchanges did not properly describe in their rules how their order types were functioning,&quot; said Andrew J. Ceresney, Director of the SEC’s Division of Enforcement. &quot;They also gave information about order types only to some members, including certain high-frequency trading firms that provided input about how the orders would operate.&quot;</td>
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<tr>
<td><strong>Van der Wel, Menkveld, Sarkar, &quot;Are Market Makers Uninformed and Passive? Signing Trades in the Absence of Quotes&quot; (2009)</strong></td>
<td><strong>U.S. futures, 1994-1997</strong></td>
<td>Unregulated or unconstrained market makers demand liquidity for a substantial part of the day and are active and informed speculators.</td>
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<td><strong>Federal Reserve Bank of New York</strong></td>
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<td><strong>Van Kervel, &quot;Market Fragmentation and Smart Order Routing Technology&quot; (2014)</strong></td>
<td><strong>U.K. equities, 2009</strong></td>
<td>&quot;However, after a trade on one venue, [HFT market makers] will quickly withdraw the additional liquidity on the other. The empirical analysis confirms that trades are followed by excessive cancellations of limit orders, and the magnitude depends on the fraction of traders who can access several venues simultaneously.&quot;</td>
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<td><strong>VU University Amsterdam</strong></td>
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<td>Wang, Chae</td>
<td>&quot;Who Makes Markets? Do Dealers Provide or Take Liquidity?&quot;</td>
<td>Massachusetts Institute of Technology Taiwanese equities, 1997-2002</td>
<td>(2003)</td>
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<td>Weller</td>
<td>&quot;Liquidity and High Frequency Trading&quot;</td>
<td>University of Chicago U.S. futures</td>
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<td>Working</td>
<td>&quot;Tests of a Theory Concerning Floor Trading on Commodity Exchanges&quot;</td>
<td>Stanford University U.S. futures</td>
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<td>Ye, Yao, Gai</td>
<td>&quot;The Externality of High Frequency Trading&quot;</td>
<td>University of Illinois U.S. equities</td>
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<td>Yildiz, Van Ness, Van Ness</td>
<td>&quot;The Role of HFTs in Order Flow Toxicity and Stock Price Variance&quot;</td>
<td>University of Mississippi U.S. equities</td>
<td>(2014)</td>
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*Note: Access to the paper has been restricted. See "The Influence of the For Profit Exchanges".*
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<td>Zigrand, Cliff, Hendershott</td>
<td>Financial stability and computer based trading</td>
<td>London School of Economics</td>
<td>2011</td>
<td>Research literature review</td>
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"High-frequency trading may potentially have some harmful effects" because "high-frequency trading is positively correlated with stock price volatility."

Self-reinforcing feedback loops in computer-based trading can lead to significant instability in financial markets; market participants become inured to excessive volatility in a cultural "normalization of deviance" until a large-scale failure occurs; research to date has not shown a persistent increase in market volatility, but HFT research is nascent.
The Wall Street Journal's "Dark Market" Series (selected articles)

"Deutsche Börse's News Service for Traders Draws Scrutiny of Investigators"
Brody Mullins and Scott Patterson, August 12, 2013
"[N]ow owned by the Deutsche Börse stock exchange, Need To Know News has operated with an overriding mission: sending data directly from the government through high-speed lines to financial firms that are able to trade on it instantly. Some have paid $375,000 a year for the service."

"High-Frequency Traders' Safeguards Come Under Scrutiny"
Scott Patterson, July 18, 2013
"The widening look at high-speed algorithms was sparked by Finra's recent investigations into high-speed-trading mishaps, Mr. Gira said. Last week, Finra and several stock-exchange regulators fined Newedge USA LLC, which is jointly owned by French banks Société Générale and Crédit Agricole CIB, $9.5 million for lax oversight of computer-driven trading firms."

"High Speed Traders Exploit Loophole"
Scott Patterson, May 1, 2013
"Fast-moving traders can get a head start in looking at key information because they connect directly to the exchange's computers, giving them the data just before it reaches the so-called public tape accessible to everyone else."

"High-Speed Traders Race to Fend Off Regulators"
Jenny Strasburg and Scott Patterson, December 28, 2012
"High-frequency trading firms are fighting to fend off regulation as scrutiny of their practice of unleashing blizzards of orders coincides with repeated technical glitches in the markets. As the firms work to convince policy makers their practices are benign or even beneficial, one of their primary tools has been research seeded by the industry itself, promoted by lobbying that has increased in recent years."

"Probe Sparks Split on Trades"
Scott Patterson, December 18, 2012
"A regulatory investigation into whether stock exchanges have given unfair advantages to high-speed traders has sparked complaints against the exchanges, fueling a broader debate about how the market operates and is regulated."

"Exchanges Get Closer Inspection"
Scott Patterson and Jean Eaglesham, November 20, 2012
"[R]egulators are stepping up oversight of stock exchanges as they scramble to catch up to trading advantages that some say have developed for sophisticated clients at the expense of ordinary investors."

"For Superfast Stock Traders, A Way to Jump Ahead in Line"
Scott Patterson and Jenny Strasburg, September 19, 2012
"At issue is whether exchanges sometimes allow high-speed trading firms to trade ahead of less-sophisticated investors, potentially disadvantaging them and violating regulatory rules."
See also "SEC Charges Direct Edge Exchanges With Failing to Properly Describe Order Types".

High Frequency Trading and "Insider Trading 2.0"

In 2013, Nanex, LLC, a market data and market research firm, documented several instances where markets reacted violently to news reports and press releases before they were generally available to the public. As a result of Nanex's research and other investigative reporting, news and other information services were called to account for selling early access to high speed trading firms. Christening these practices "Insider Trading 2.0," the New York Attorney General launched an investigation, the U.S. Federal Reserve changed its procedures, and even Warren Buffett stepped in.

Researchers also found that the Securities and Exchange Commission inadvertently gave high-speed traders advance looks at corporate filings.

"Thomson Reuters Gives Elite Traders Early Advantage"
Eamon Javers, CNBC, June 12, 2013
"A closely watched consumer confidence number that routinely moves markets upon release is accessed by an elite group of traders, for a fee, a full two seconds before its official release, according to a document obtained by CNBC."

"Traders Pay for an Early Peek at Key Data"
"On the morning of March 15, stocks stumbled on news that a key reading of consumer confidence was unexpectedly low. One group of investors already knew that. They got the University of Michigan's consumer report two seconds before everyone else....In a single second, according to a Wall Street Journal analysis, traders from various firms bet nearly seven million shares that equity markets would decline - which was exactly what happened when news of the survey became widely known."

"A.G. Schneiderman Applauds Decision By Business Wire To Prohibit High-Frequency Traders From Purchasing Direct News Feed"
"High-frequency traders who drain the value out of market-moving information in the milliseconds before it becomes available to other investors erode confidence in our markets and skim from the rest of the investing public, which hurts the entire market."

"Fast Traders Are Getting Data From SEC Seconds Early"
Ryan Tracy and Scott Patterson, Wall Street Journal, October 29, 2014
"Hedge funds and other rapid-fire investors can get access to market-moving documents ahead of other users of the Securities and Exchange Commission’s system for distributing company filings, giving them a potential edge on the rest of the market."
Press Editorials

"Stopping the Stock Market Arms Race"
Bloomberg, June 16, 2014
“When large investors such as mutual funds try to trade at quoted prices, the shares disappear from their screens. High-speed traders place and cancel millions of orders a day to sniff out demand. When they detect interest in a stock, they jump ahead and buy the shares on all the markets, then sell them to fund managers at a slightly higher price.” See also these Bloomberg editorials: "Wall Street Trades at Speed of Light Need Traffic Cops: View" (January 3, 2012), "Knight Blowup Shows How High-Speed Traders Outrace Rules" (August 7, 2012), "U.S. Leads in High-Frequency Trading, Trails in Rules" (October 2, 2012), "High-Frequency Trading Prospers at Expense of Everyone" (December 26, 2012)

"Wait a second: The latest cock-up on Wall Street shows that more safeguards are needed"
Economist, August 11, 2012
“This newspaper seldom finds itself on the side of restraining either technology or markets. But in this case there is a doubt whether the returns justify the risk. Society needs a stockmarket to allocate capital efficiently, rewarding the best companies with higher share prices. But high-frequency traders are not making decisions based on a company’s future prospects; they are seeking to profit from tiny changes in price. They might as well be trading baseball cards. The liquidity benefits of such trading are all very well, but that liquidity can evaporate at times of stress. And although high-frequency trading may make markets less volatile in normal times, it may add to the turbulence at the worst possible moment.”

"Dredging Wall Street’s dark pools"
Financial Times, June 26, 2014
“[T]echnological innovation has outpaced market supervision to the detriment of investors. The US authorities are finally waking up to the problem. Mr Schneiderman has opened an inquiry into whether US stock exchanges and other trading platforms have given high-speed traders an undue advantage. The SEC wants to force more disclosure on dark pools...These are welcome initiatives. Equity markets are not the playground of traders but places where retail investors deploy their savings. As regulators catch up with reality, they must make sure that markets serve non-professional users that access them.” See also these Financial Times editorials: “Taming Trading” (August 23, 2010), “Calmer markets” (October 4, 2010), “Asia takes on algos” (August 14, 2012), and “Expelling gremlins from the exchange” (August 23, 2013).

"Volatile markets: twitchy about Twitter"
The Guardian, April 26, 2013
“Using algorithms, dealing-room computers conduct hundreds of thousands of automatic trades within seconds. These can sometimes steady or smooth markets, as when algorithms correct an error made by a fat-fingered human. But other times they can make things worse, by exacerbating a dramatic move in asset prices.”

"When Speed Kills"
The Japan Times, August 14, 2012
“Market officials and regulators are increasingly skeptical of the notion that faster is by definition better.”

"Trading in the Dark"
The New York Times, April 7, 2013
"Potential interactions between the off-exchange venues and the high-speed, computer-driven trading that now dominates the stock market are also cause for worry, because increasingly complex systems can malfunction in unexpected and catastrophic ways.” See also "The Dark Pool Iceberg" (June 28, 2014).

"SEC right to look hard at ‘dark pools“
Newsday, June 10, 2014
"In the past week, Securities and Exchange Commission Chairwoman Mary Jo White has started to make some meaningful moves to help. She proposed a broad set of new rules to strengthen oversight, improve disclosure and limit the risk of market meltdowns. Chief among them is improving oversight of high-speed traders who use computers to take lightning-fast advantage of tiny opportunities in the market. These traders are not required to register with the SEC or the Financial Industry Regulatory Authority, a private company that acts as a self-regulating organization for the markets. It was high-speed trading that caused the Dow Jones industrial average to drop 700 points in minutes in 2010."

"High-frequency trading corrupts markets: Our view"
USA Today, April 1, 2014
"It's an elaborate and highly destructive form of cheating. It harms the people who matter the most - long-term investors who buy into companies with the motive of funding growth and sharing profits. It rewards a select cadre of traders who don't care about the companies whose stocks they trade.” See also these USA Today editorials: "Flash-crash analysis leaves investors reason to worry" (October 7, 2010), "Time to put the brakes on high-frequency stock trades” (May 18, 2010), "High-frequency trading insanity" (September 26, 2012).

“The Dark of Knight”
Wall Street Journal, August 2, 2012
"From the 2010 ‘flash crash’ to trading snafus at Facebook's initial public offering in May, the basic plumbing of the equity markets has never seemed so troubled."

"Is high-frequency stock trading stepping over a legal line?"
Washington Post, April 10, 2014
"Clearly, a new generation of high-frequency traders has figured out how to arbitrage - or exploit - a time advantage, measured in fractions of a second....We can’t slow down technology, but we should insist on rules to keep markets free, open and fair."
Op-eds and Commentary

"Themis Trading Opening Statement from CFTC TAC Panel on High Frequency Trading"
Sal Arnuk and Joseph Saluzzi, Themis Trading, June 4, 2014
"The best solutions to complexity are usually simple ones. We have three that we believe can change equity markets for the better."

See also the Themis Trading Blog, where Sal Arnuk and Joe Saluzzi write some of the most thoughtful commentary on the markets anywhere.

"What Really Happened in the US Government Bond Market on the Morning of October 15th?"
Sal Arnuk and Joseph Saluzzi, Themis Trading, October 21, 2014
"[S]omething is wrong when the safest bonds in the world experience such a rapid price move in such a short time period. Unfortunately, we say to our bond market friends, welcome to our world!"

"Stock-Order Rebates Should Be Stopped, Arnuk Says"
Sal Arnuk and Joseph Saluzzi interviewed by Erik Schatzker and Stephanie Ruhle Bloomberg, September 20, 2012
"What we've done is we've taken two deep liquidity pools and taken their worst feature - the worst feature - amplified it a billion times, mechanized it, and now that is our modern market structure."

"Serving All, Not Just the Elite Few"
"Trading today is mostly computerized scalping done under a sanitized name – ‘market making.’"

"Too Fast to Fail: Is High-Speed Trading the Next Wall Street Disaster?"
Nick Baumann, Mother Jones, January/February, 2013
"The chief executives of publicly traded companies—who are hired and fired based on stock prices—increasingly worry that their shares could be sent into a free fall by an algorithmic feeding frenzy. The current markets have created a 'somewhat disjointed world between what a company does and what its stock does,' the CEO of one billion-dollar, NYSE-traded company told Mother Jones."
See also "Yet More Evidence That High-Frequency Trading is Bad for Us" (December 4, 2012).

"HFT leads small issuers to exit public listings"
David Beatty, Financial Post, September 4, 2014
"Since the onset of high frequency trading and the erosion of true market makers, liquidity in public companies has been concentrating in an ever smaller group of large-cap stocks. As a consequence of increasing costs, caused by HFT-driven market dynamics, dealers have been downsizing their sales support and research capability for small and mid-sized corporations."

"Introduction to HFT Scalping Strategies"
Haim Bodek and Mark Shaw, Decimus Capital Markets, LLC / Haim Bodek Consulting, November 2012
"HFT scalping’s impact on the equity markets include high frequency price fluctuations, high order cancellation rates and liquidity gaps."

"Not so fast: The risks posed by high-frequency trading"
Buttonwood, Economist, August 6, 2011
"The problem may be that, unlike marketmakers, HFT investors have no obligation to trade in difficult
conditions.” See also Buttonwood’s notebook, “HFT: the backlash continues” (May 7, 2014).

"Rise of the Machines"
"CREW studied the lobbying and campaign contribution records of 48 companies known for high frequency trading. Their campaign contributions soared by a staggering 673 percent between the 2008 and 2012 cycles, and their lobbying spending jumped 93 percent.”; “HFTs have aggressively commissioned research and circulated it on Capitol Hill to buttress arguments against regulation.”

"SEC must put a stop to casino markets"
Leon Cooperman, Sal Arnuk and Joseph Saluzzi, Financial Times, September 24, 2012
"Clearly, the SEC’s market structure experiment has failed. Unless something changes, confidence-shaking events will only increase in frequency.”

"High Frequency Trading Reform: The Short Term and the Longer Term"
"[H]igh frequency traders will argue that, if they could not purchase their current trading advantages, they would be less willing to intervene aggressively in equity markets to narrow the spreads. The cost of reform thus might be wider spreads. This is not false, but the advantages of their aggressive intervention may be exaggerated. The social benefits from high frequency trading are uncertain and possibly illusory.”

"The Responsible Way to Rein in Super-Fast Trading"
Gary Cohn, Wall Street Journal, March 20, 2014
"In the past year alone, multiple technology failures have occurred in the equities market, with a severe impact on the markets’ ability to operate. Even though industry groups have met after the market disruptions to discuss responses, there has not been enough progress. Execution venues are decentralized and unable to agree on common rules. While an industry-based solution is preferable, some issues cannot be addressed by market forces alone and require a regulatory response.”

"Measures needed to curb advantage of High Frequency Trading"
Richard Curran, Irish Independent, February 27, 2014
"But when it comes to the utilisation of multi-million dollar software, located next to the exchange server, combined with the purchase of early information that is potentially market moving, somebody has to cry halt.”

"Defining high-frequency trading's US level of evil"
John Dizard, Financial Times, June 20, 2014
"On Wall Street, people’s sentiments about high-frequency equities trading is largely determined by whether they believe there is plenty of liquidity to go around, or not. (In Europe, there is agreement across the political spectrum that HFT is inherently evil.)”

"The Day The Market Almost Died (Courtesy Of High Frequency Trading)"
Tyler Durden, ZeroHedge, May 6, 2010
"What happened today was no fat finger, it was no panic selling by one major account: it was simply the impact of everyone in the HFT community going from port to starboard on the boat, at precisely the same time.”
See also http://www.zerohedge.com/taxonomy_vtn/term/140 and http://www.zerohedge.com/taxonomy_vtn/term/12411
"Regulator puts a spotlight on high-frequency trading."
Boyd Erman, The Globe and Mail, June 18, 2012
"From retail investors commenting on The Globe and Mail's website to Tony Fell, who once ran the country's biggest brokerage, the message is the same: The markets are seen as a casino where high-frequency traders are winning too often for it all to be just chance."

"A new type of market crash proliferates"
The Economist, August 31, 2013
"Even before the glitches, the SEC was taking increased interest in potential trading problems and how they might be disclosed. In March it published a proposal known as Regulation SCI (systems compliance and integrity). Exchanges and banks are resisting one of its requirements, which is to report blackouts even if they do not lead to anything as severe as trading halts. America's regulators are often accused of being heavy-handed. But forcing more transparency on the black boxes that have replaced screaming humans on Wall Street must be a good thing."

"High Frequency Trading HFT panel (Finance Watch Conference)"
Finance Watch (2012)
"Significant concerns have been raised about the quality of liquidity provided, as well as the risks posed in terms of stability and integrity for our financial markets by these types of trading."
See also www.finance-watch.org.

"Dark times for opaque trading platforms"
Jeremy Grant, Financial Times, June 26, 2014
"It has been an open secret in the industry that some bank dark pools have admitted certain kinds of HFT players, in spite of their blandishments to the contrary."

"High-frequency trading and the $440m mistake"
August 10, 2012
Tim Harford, BBC Radio 4
"Humans still watch the systems, but the computers move far too quickly for us to react to everything they do - and at Knight Capital, the computer glitch meant the company was making trades it didn't intend to make. That's how to lose almost half a billion dollars in a little over half an hour."

"Toward A U.S. Equity Market Structure That Serves All Investors"
Micah Hauptman, Consumer Federation of America (2014)
"While competition and technology have brought great progress to our equity markets, the pendulum has swung too far. Excessive competition has resulted in a market that is unnecessarily complex, fragmented, lacking basic transparency mechanisms, and ridden with conflicts of interest; and, the technological arms race has led to trading activities that disadvantage long-term investors, expose the financial system to excessive risks, and shake investor confidence."

"High frequency trading needs severe regulation"
"HFT is now so dominant it overwhelmss everyone so there is no countervailing force to the direction taken by the computers."

"Risiken des Hochfrequenzhandels: Das systemische Risiko der Dummheit" ("Risks of High(236,946),(999,999)
High Frequency Trading, a bibliography
of evidence-based research
March 2015

"Traders may have gotten last week’s Fed news 7 milliseconds early"
"It is the reality of how much trading activity, particularly of the ultra-high-frequency variety is really a dead weight loss for society."

"Ultra-fast trading algorithms are a systemic risk to our economy - all the more so when no one seems to be able to control their behavior." (Google Translate)

"The high-tech arms race that’s causing stock market ‘tsunamis’"
Neil Johnson, CNN, August 13, 2014
"My fellow researchers and I recently uncovered glimpses of what is already going wrong in the form of escalating patterns of ‘sub-second tsunamis.’ These tsunamis are huge spikes and dips in the price of an individual stock. Although the Flash Crash was fast, lasting only a few minutes, these sub-second tsunamis are over in the blink of an eye -- and there are thousands of them. A 10% daily change in a major stock would guarantee breaking news coverage, but these tsunamis typically send the price plummeting to almost zero. However they go unnoticed since the price quickly recovers as other algorithms jump in for the kill."

"Closer Look: No Rewind Button for Everbright Securities"
Fan Junli, Caixin Online, August 19, 2013
"The Everbright incident has raised alarms on the limits of risk control and supervision capacity in HFT, which refers to rapid securities trading that relies on technological tools and computer algorithms."

"Shining some light into the monied world’s ‘dark pools’"
Ted Kaufman, Delaware Online, February 16, 2015
"High Frequency Trading (HFT) now accounts for over fifty percent of all trading volume in the United States. It began to grow rapidly when SEC rules were changed to allow the movement of stock trading away from a few exchanges. Much of that trading is now done in “dark pools,” so named because they aren’t required to have the transparency of the traditional exchanges. That means no one, including the SEC, knows what is going on as High Frequency traders use super-fast computer algorithms to find and exploit price variations that may come and go in nanoseconds."

"Preventing the Next Flash Crash"
"America’s capital markets, once the envy of the world, have been transformed in the name of competition that was said to benefit investors. Instead, this has produced an almost lawless high-speed maze where prices can spiral out of control, spooking average investors and start-up entrepreneurs alike."

"A Dark Magic: The rise of the robot traders"
Laurence Knight, BBC News, July 8, 2013
"But, what made things far worse was a ‘hot potato’ effect: amid the confusion, one by one the robot traders tried to cut and run, and the stock exchange's computers got swamped."

"Testimony on 'Computerized Trading: What Should the Rules of the Road Be?'"
David Lauer testimony before the U.S. Senate Committee on Banking, Housing, and Urban Affairs
Subcommittee on Securities, Insurance and Investment, September 20, 2012
“US equity markets are in dire straits. We are truly in a crisis.”

"Public Comment on Consultation Report"
R. T. Leuchtkafer, August 12, 2011
"A basic function of any market is to produce a quote. Today’s HFT quotes are toxic, a hoax on equities markets."
See also “No more ‘hot potatoes’ please” (October 5, 2010) and "File No. 07-02-10" (April 16, 2010).

"Why Couldn’t Wall Street Weather a Storm?"
"And thanks to software errors in high-speed trading firms and ‘fat finger’ errors by human traders, it’s becoming clearer that many major market participants simply have not properly tested their existing trading systems or prevented fraud and error from creeping into their trading books."

"High-frequency trading - split seconds"
Lex, Financial Times, September 26, 2012
"Constraining the relentless advance of technology is rarely easy. But that is no excuse for not trying when its potential effects may be damaging."

"A Speed Limit for the Stock Market"
Roger Lowenstein, New York Times, October 1, 2012
"The 'liquidity' H.F.T. provides is long past the point of being helpful."

"Be Grateful for Drizzle"
"In a New York coffeehouse, a former high-frequency trader told me matter of factly that one of his colleagues had once made the simplest of slip-ups in a program: what mathematicians call a ‘sign error’, interchanging a plus and a minus. When the program started to run it behaved rather like the Knight program, building bigger and bigger trading positions, in this case at an exponential rate: doubling them, then redoubling them, and so on. 'It took him 52 seconds to realise what was happening, something was terribly wrong, and he pressed the red button,' stopping the program. 'By then we had lost $3 million.' The trader’s manager calculated ‘that in another twenty seconds at the rate of the geometric progression,’ the trading firm would have been bankrupt, ‘and in another fifty or so seconds, our clearing broker’ – a major Wall Street investment bank – ‘would have been bankrupt, because of course if we’re bankrupt our clearing broker is responsible for our debts … it wouldn’t have been too many seconds after that the whole market would have gone.’"

"Markets: In search of a fast buck"
Arash Massoudi and Michael Mackenzie, Financial Times, February 20, 2013
"The potential benefits to investors seem clear: trading will become cheaper and more transparent...But the potential downsides are markets plagued by computer errors and outages. Most worrying of all: the risk of a global flash crash across major markets linked by the speed traders."

"High Frequency Trading: Wall Street's Doomsday Machine?"
Christopher Matthews, Time Magazine, August 8, 2012
"[H]igh-speed trading systems may also pose risks to the stability of the overall financial system."
"High Frequency Trading - Maybe This Time"
Jim McCaughan, CEO, Principal Global Investors, April 7, 2014
"Technology and the proliferation of trading venues have moved faster than regulation, creating structural issues in markets that need to be addressed. To be clear, neither technology nor the increased number and variety of exchanges is the true issue. In fact, the efficiency of computerized trading and greater choice in trading venues are, on balance, very good things – having improved the process of price discovery and reduced transaction costs for investors. The issue with certain HFT firms is that they take advantage of speed and preferential access to exchanges to engage in predatory trading practices. The New York Attorney General refers appropriately to the situation as 'insider trading 2.0.'"

"Recommendations for Equitable Allocation of Trades in High Frequency Trading Environments"
"This paper (1) acknowledges and summarizes much of the relevant published research (2) discusses some of the HFT strategies that likely run counter to good public policy and (3) makes six recommendations that, if implemented, would not preclude any current HFT strategies, but would likely restore some competitive advantage to market participants that would be willing to expose their resting orders to market risk for more than fleeting milliseconds."

"Why High-Frequency Trading Doesn't Compute"
Jim McTague, Barrons, August 11, 2012
"Markets have been jarred by four major computer mishaps this year, including the recent one at Knight Capital. It's time to rein in the Street's speed demons: trading bots."

"If HFT is here to stay it needs regulating"
Paul Murphy, Financial Times, February 23, 2014
"[I]f HFT is here to stay, the broader investor community needs assuring that it is robustly and expertly regulated – and unfortunately there is not a lot of evidence that this is the case."

"The Rise of the HFT Machines"
Nanex, LLC
"The following animated GIF chronicles the rise of the HFT Algo Machines from January 2007 through January 2012."
See also http://www.nanex.net/FlashCrash/OngoingResearch.html

"Dennis Kelleher on PBS Discussing High Frequency Trading"
"There's been shockingly little done regarding our capital markets since the flash crash."
See also www.bettermarkets.com.

"Cuban, Cooperman: Curb High-Frequency Trading"
Bruno J. Navarro, CNBC, October 2, 2012
(Includes CNBC interviews of Mark Cuban and Leon Cooperman)
"There is no value to HFT, period. End of story."

"Frankenstein Takes Over the Market"
"This week, yet another Wall Street firm most people have never heard of, relying on a computerized trading program that they can't possibly understand, shook investors' faith in the market."
"Strong and Fast Markets, but No Time to Think"
"The same computerization and increased competition that provided the benefits also weeded out people who had the obligation to step up in times of stress, and virtually eliminated the ability of people and institutions to slow or halt markets when something goes badly wrong."
See also "Sacrificing Sense for Speed in Markets" (April 10, 2014).

"Can High-Frequency Trading Drive the Stock Market Off a Cliff?"
Wei Pan, Alex Sandy Pentland, Ren Cheng and Lisa Emsbo-Mattingly
MIT Sloan Management Review, June 18, 2013
"[H]igh-frequency trades influenced the market price, which then affected the next trades of the high-frequency trading firms. As a result, many of these high-frequency trading firms started to sell together, in synchrony, which added up to billions of dollars worth of sell trades per second. This was an event of enormous magnitude, even for the U.S. equity market. The synchronized selling caused prices to collapse."

"A Dark Magic"
Robert Peston, BBC Radio 4, July 7, 2013
"And what may disturb you is that it's like a terminator movie with competing algorithms clashing with each other and on occasion causing market meltdowns."

"Trading algorithmique: mobilisation contre la 'menace' des ordinateurs boursiers" ("Algorithmic Trading: mobilization against the 'threat' of trading computers")
Edouard Pflimlin, Le Monde, May 20, 2013
"The battle against the excesses of algo-trading only start." (Google Translate)

"How high-frequency traders chisel genuine investors"
"One of the most important roles of any stock exchange is to raise capital for companies. HFTs make big money for themselves but never contribute a cent to capital raisings."

"Long-term investors would benefit from Tobin tax"
John Plender, Financial Times, September 28, 2011
"It is a paradoxical result of increased competition from off-exchange trading platforms and from regulatory developments such as Europe’s Markets In Financial Instruments Directive that long-term investors are being disadvantaged. A financial transactions tax might help redress the balance."

"Themis Trading LLC Joseph Saluzzi: Masters in Business"
Barry Ritholtz interviews Joseph Saluzzi, Bloomberg Radio, March 2, 2015
"Why did the limit order books that we talked about before just disappear? It's not really real liquidity. It's kind of phantom liquidity."

"The problem with high frequency trading"
Felix Salmon, BBC Radio, October 6, 2012
"But if you look at what's happened over the past five years, since 2007, the benefits of high-frequency trading have pretty much plateaued. And the downsides are becoming more and more obvious."
See also "The Problems of HFT, Joe Stiglitz edition" (April 16, 2014).
"Cramer Slams High-Speed Trading"
Drew Sandholm, CNBC, September 18, 2012
(Includes excerpts from "Mad Money with Jim Cramer")
"To me, right now, the high-speed traders are this generation's equivalent of the German machine guns that mowed down British soldiers by the thousands and the people being annihilated by the traders? That's you, the average investor, just trying to using stocks to save some money as generations have before you."

"Turbo-Aktienhändler: Dann wird geschossen" ("Turbo Stock Trader: 'Then is shot'")
Christoph Scheuermann, Spiegel Online, August 23, 2013
"On one of those crazy days was a lot of money lost, 'because an algorithm is haywire,' as Breuer says. The algorithm [bit] like a rabid ferret. Only after seven minutes, they were able to bring it under control, but it was too late." (Google Translate)

"Schwab Statement on High-Frequency Trading"
Charles Schwab, Chairman, and Walt Bettinger, CEO, Charles Schwab Corporation, April 3, 2014
"High-frequency traders are gaming the system, reaping billions in the process and undermining investor confidence in the fairness of the markets. It's a growing cancer and needs to be addressed."

"The (Questionable) Legality of High-Speed 'Pinging' and 'Front Running' in the Futures Markets"
"HFT firms might arguably be the fastest sharks swimming in the oceans of financial data, but the CFTC and private plaintiffs might have nets—in the form of relevant statutory and regulatory provisions—capable of catching them"

"The Spider and the Fly"
Rajiv Sethi, August 3, 2013
"If one wants to argue that the new organization of markets has been beneficial to investors, one needs to make the case that the costs of financial intermediation in the aggregate have gone down. Smaller bid-ask spreads have to be balanced against the massive increase in volume, the profits of the new market makers, and most importantly, the costs of high-frequency trading."
See also "The Risk and Reward in High Frequency Trading" (December 7, 2012) and "The New Market Makers" (June 4, 2010).

"Superfluous Financial intermediation"
Rajiv Sethi, April 6, 2014
"[A]n arms race among intermediaries willing to sink significant resources into securing the slightest of speed advantages must ultimately be paid for by investors."

"A Tax to Kill High Frequency Trading"
Lee Sheppard, Forbes.com, October 16, 2012
"The United States should adopt a financial transactions tax (FTT) to kill high frequency trading (HFT) by removing the juice from this pernicious practice."

"The danger of high-frequency traders: Why critics fear HFTs are undermining markets, one penny at a
"Quick View: Twitter hack shows tech dangers"
Philip Stafford, Financial Times, April 24, 2013
"As the UK government-backed Foresight report into computer-based trading highlighted, one of the dangers within all automated systems lies in what is known as a positive feedback loop, in which a small change in computer trading feeds back on itself, triggering a bigger change, which in turn feeds back on itself, and so on. The process amplifies volatility, especially in interlinked markets."

"Quick View: Eurex caught out"
Philip Stafford, Financial Times, February 20, 2014
"As we have seen with outages around the world, too often the complex, subsecond interlinked markets feel very brittle. One of the great unknowns of the market infrastructure world is whether enough resources are being devoted to the technology to withstand shocks."

"An ode to high-frequency trading"
Benn Steil, Financial Times, September 13, 2010
"Those magnificent men and their trading machines,
They trade up, diddly, up, up!
They trade down, diddly, down down!
They stuff lots of quotes, then they empty the screens,
With their up, diddly up, up!
And their down, diddly, down down!"

"Fair Play Measured in Slivers of a Second"
"Two seconds may not seem like much, but for high-speed traders with supercomputers, it’s plenty."

"Barclays Suit Sheds Light on Trading in Shadows"
"The high-frequency trading firms have broadly defended their practices by arguing that they bring liquidity to the market. And there’s no doubt that the rise of electronic trading, much of it conducted by high-frequency traders, has lowered trading costs and narrowed the spread between bid and ask prices, which benefits investors. But it’s hard to discern what benefit these firms provide when they manage to insert themselves between buyers and sellers for a mere nanosecond."

"Tapping the Brakes: Are Less Active Markets Safer and Better for the Economy?"
"As we briefly noted earlier, there are a variety of ways by which HFT results in sophisticated versions of front running. Co-location, the fact that HFT can pay to get access to business news releases before others, and have been given other advantages has resulted in an unlevel playing field, allowing them to garner rents for themselves at the expense of others. Moreover, as we noted earlier, as confidence in markets erodes, transactions shift out of markets, and the advantages of markets (including their
transparency) are lost."

See also "The Problems of HFT, Joe Stiglitz edition" (April 16, 2014).

"How NYSE, Nasdaq profit off 'Flash Boys"
Jonathan M. Trugman, NY Post, April 6, 2014
"At the end of the day, fundamentals rule, but when exchanges that are in charge of oversight enable and are aiding, abetting and profiting by giving share pricing data early to preferred customers, the game really is rigged. The exchanges are the real 'Flash Boys.' It's time to clean them up."

"Reign of the High-Frequency Trading Robots"
Wallace Turbeville, U.S. News and World Report, October 18, 2013
"HFT traders often do supply executable price quotes, which superficially increase liquidity. True liquidity, however, comes when offers can be relied upon, allowing investors to predict whether the transactions they seek can be completed within their preferred price range. Because HFT traders can morph from providers to consumers of liquidity whenever the herd abruptly shifts from buy to sell, they create uncertainty rather than predictability."
See also "Are Academics for Hire Influencing the HFT Debate?" (March 25, 2013), "High Frequency Trading" (March 8, 2013), and "The Real Cost of High Frequency Trading" (April 14, 2014).

"Hurrying Into the Next Panic?"
Paul Wilmott, New York Times, July 28, 2009
"Thus the problem with the sudden popularity of high-frequency trading is that it may increasingly destabilize the market."

"When Will Retail Investors Call It Quits?"
Jason Zweig, Wall Street Journal, August 2, 2012
"So much for the reassurances from regulators and stock-exchange officials that a repeat of the ‘flash crash’ is impossible."
Books and Documentaries

"Broken Markets: How High Frequency Trading and Predatory Practices on Wall Street are Destroying Investor Confidence and Your Portfolio"
Sal L. Arnuk and Joseph C. Saluzzi (2012)
"The market has been hijacked. An evolved class of leveraged short-term, high-speed traders, sometimes called high frequency traders, who trade massive amounts of shares based on proprietary algorithms, has eclipsed other types of traders."
See also the Themis Trading Blog, where Sal Arnuk and Joe Saluzzi write some of the most thoughtful commentary on the markets anywhere.

"The Problem of HFT"
Haim Bodek (2013)
"With automation, the US equities markets had evolved into a vast complex machine, one that was purposefully well-tuned to the nuances of HFT scalping strategies. Modern HFT wasn't a paradigm shift because its innovations brought new efficiencies into the marketplace. HFT was a paradigm shift because its innovations proved that anti-competitive barriers to entry could be erected in the market structure itself to preference one class of market participant above all others." See also "SEC Charges Direct Edge Exchanges With Failing to Properly Describe Order Types".

"The Payoff"
Jeff Connaughton (2012)
"Our stock market had changed dramatically. No one understood how these changes were affecting average investors. Today's stock market is a constantly evolving, bewilderingly complex electronic labyrinth."

"Krach machine: Comment les traders à haute fréquence menacent de faire sauter la bourse" ("Crash machine: How high frequency traders threaten to blow up the stock exchange")
Lelièvre, Pilet (2013)
"Qui sont ces traders qui agissent pratiquement à la vitesse de la lumière?" ("Who are these traders who operate at nearly the speed of light?")

"Crapshoot Investing"
Jim McTague (2011)
"The stock market has changed radically since 2005, yet few persons realized the greatness of the seismic shift until May 6, 2010, when the major averages collapsed over the course of 10 minutes."

"Dark Pools: High-Speed Traders, A.I. Bandits, and the Threat to the Global Financial System"
Scott Patterson (2012)
"Insiders were slowly realizing that the push-button turbo-trading market in which algos battled algos inside massive data centers and dark pools at speeds measured in billionths of a second had a fatal flaw." See also "SEC Charges Direct Edge Exchanges With Failing to Properly Describe Order Types".

"Finance Folle: L'Attaque des Robots Traders"
TV Monde 5 (2012)
"Developed by mathematicians, robots built on powerful algorithms perform thousands of orders in the
market in just a few seconds. This documentary, produced by TV5 Monde, exposes this contemporary phenomenon in the world of finance."

"Ghost Exchange"
Arbitrage Pictures (2012)
Directed by Camilla Sullivan
"I think the flash crash sent a clear message that there's something wrong in our system."

"Backlight - Money and Speed: Inside The Black Box"
VPRO, Dutch public broadcasting (2011)
Directed by Marije Meerman.
Produced by Mariska Schnider for the series "Backlight."
"On May the 6th 2010, at 1400 hours, 42 minutes, and 44 seconds, the U.S. stock markets go into free fall. The Dow Jones takes the fastest and most dramatic nosedive in its history, an event that will be remembered as the 'Flash Crash.'"

"Wall Street Code"
VPRO, Dutch public broadcasting (2013)
Directed by Marije Meerman.
Produced by Jenny Borger, Helen Goosens, and Marie Schutgens for the series "Backlight."
"Super-quick computers and advanced mathematic formulas have largely taken over trading on the financial markets from human beings. Algorithms, which seem to have a life of their own. Algorithms secretly lie waiting for the moment that your Apple share or your pension money gets in the market."
“Flash Boys” by Michael Lewis

“Flash Boys”  
Michael Lewis (2014)  
“As they worked through the order types, the Puzzle Masters created a taxonomy of predatory behavior in the stock market. Broadly speaking, it appeared as if there were three activities that led to a vast amount of grotesquely unfair trading. The first they called electronic front-running - seeing an investor trying to do something in one place and racing ahead of him to the next (what had happened to Katsuyama when he traded at RBC). The second they called rebate arbitrage - using the new complexity to game the seizing of whatever legal kickbacks, called rebates within the industry, the exchange offered without actually providing the liquidity that the rebate was presumably meant to entice. The third, and probably by far the most widespread, they called slow-market arbitrage. This occurred when a high-frequency trader was able to see the price of a stock change on one exchange and pick off orders sitting on other exchanges before those exchanges were able to react. This happened all day, every day, and very likely generated more billions of dollars a year than the other strategies combined.” (From an adaptation published in The New York Times.)

60 Minutes

"Is the U.S. stock market rigged?"  
Steve Kroft, CBS News, March 30, 2014    
"It's crazy that it's legal for some people to get advance news on prices and what investors are doing. It's just nuts. Shouldn't happen."

Reviews

“Flash Boys: Michael Lewis muscles into the dodgy world of high-frequency trading”  
Simon Houpt, The Globe and Mail, April 4, 2014  
"Lewis’s primary achievement is in making the opaque world of high-frequency trading (HFT), in which computer algorithms execute millions of trades within seconds, accessible and sometimes even thrilling to the lay reader. He argues that HFT creates a 'class system, rooted in speed, of haves and have-nots,' in which deep-pocketed, technologically astute and savvy traders can, in a practice known as 'front-running,' sniff out others' trade orders and then insert themselves between sellers and buyers to make a profit without any risk."

“Scalpers, Inc.”  
"Flash Boys is a number of things, one of the most important being an exposition of exactly what is going on in the stock market; it's a one-stop shop for an explanation of high-frequency trading (hereafter, HFT). The book reads like a thriller, and indeed is organised as one, featuring a hero whose mission is to solve a mystery."

“Hobbling Wall Street Cowboys”  
Janet Maslin, New York Times, April 1, 2014  
"[Flash Boys] also explores the breakup of big, central stock exchanges into many small ones; the impossibility of investors’ knowing exactly what is being done with their money; and the immense new opportunities for skimming, kickbacks, secret fees and opacity that the new system has spawned. Because Mr. Lewis is at the helm finding clear, simple metaphors for even the most impenetrable
financial minutiae, this tawdry tale should make sense to anyone. And so should its shock value. 'Flash Boys' is guaranteed to make blood boil."

"Flash Boys: Michael Lewis does it again"
Steve Pearlstein, Washington Post, April 12, 2014
"[I]n 'Flash Boys,' Lewis reveals how a new crop of investment firms has conspired with the big banks and the stock exchanges to use high-speed computers and complex software algorithms to skim pennies from the real investors who provide equity capital to the economy."

"High on Speed"
"With his new book, Flash Boys, Michael Lewis has made a story that very few people in America had known, or cared, anything about - the rise of high-frequency trading on Wall Street - into the object of national outrage."

CNBC
Michael Lewis and a central figure in "Flash Boys," Brad Katsuyama, debated a stock exchange executive on CNBC shortly after "Flash Boys" was published. Highlights of "The fight that stopped NYSE trading" here. The full debate here.

Interviews

"Michael Lewis calls Wall St. 'unfair playing field'"
Matt Lauer interviews Michael Lewis, The Today Show, April 1, 2014
"I'm following the story of people - actually of Wall Street insiders - trying to figure out how this stock market works because they themselves don't understand."

"Michael Lewis discusses his latest book: 'Flash Boys: A Wall Street Revolt'"
Charlie Rose interviews Michael Lewis, March 31, 2014
"The rigging of markets is a response to a decline in the natural usefulness of the institutions at the heart of capitalism."

"Michael Lewis on High-Frequency Trading and Markets"
Stephanie Ruhle and Erik Schatzker interview Michael Lewis, Bloomberg, April 2, 2014
"Big pension fund managers and mutual fund managers saw when they tried to execute big orders - oh my god - it's like someone knows I want to buy before I buy."

"Open Phones on Flash Boys"
Peter Slen interviews Michael Lewis, C-SPAN, April 5, 2014
"Imagine a ticket scalper, someone who figures out that the show's going to be sold out, runs up, buys tickets at the box office price and turns around and sells them at double the price to people who walked up to see the show."

Other interviews

"High Speed Reality Check"
Aaron Sorkin, Joe Kernan, Becky Quick interview Joe Saluzzi of Themis Trading, CNBC, March 31, 2014
"The system is dominated by scalpers....I guarantee you once you read this book your blood will boil."

"High Frequency Trading Neither Good or Bad: Arnuk"
Stephanie Ruhle and Erik Schatzker interview Sal Arnuk of Themis Trading, Bloomberg, March 31, 2014
"The system is set up to insert the maximum number of intermediaries between natural buyers and natural sellers."

"Flash Boys": Supporting Evidence

Much of the research in this bibliography unequivocally supports the central narratives of Michael Lewis's "Flash Boys": To the disadvantage of long-term investors, high frequency trading firms front-run demand, manipulate market structure defects, manipulate prices, post phantom quotes, and exert improper influence on stock exchanges. The following is a recap of some of the evidence supporting these points from institutions like the SEC, Princeton, the University of Chicago, Nasdaq, Northwestern University, and industry regulator FINRA, among many others.

The Australia Industry Super Network estimated that high frequency traders cost long-term Australian investors an average A$1.6 billion a year. Baron et. al. (2014) found that "HFTs have strong incentives to take liquidity and compete over small increases in speed in an industry dominated by a small number of incumbents earning high and persistent returns." Boni et. al. (2012) found that excluding high frequency traders from a market center improved it, and led to lower volatility, less front running, and higher execution quality for institutional traders. Boulton et. al. (2012) discovered that "seemingly fleeting events, such as the flash crash, can have dramatic and lingering effects on shareholder wealth and market quality." Budish et. al. (2013) concluded "that the [HFT speed] arms race is socially wasteful -- a prisoner's dilemma built directly into the market design -- and that its cost is ultimately borne by fundamental investors via wider spreads and thinner markets."

Clark-Joseph (2013) found that "HFTs appear to trade ahead of predictable demand innovations...[and] HFTs could have a destabilizing influence on prices if suitable positive-feedback mechanisms exist." Ding et. al. (2013) compared the relative speeds of investor data feeds to the exchange proprietary data feeds typically used by high frequency traders and found a substantial advantage for the proprietary data feeds. Industry regulator FINRA (2014) alleged a firm's high frequency trading customers employed "aggressive, potentially destabilizing trading strategies in illiquid securities." Gao and Mizrach (2013) found that high frequency traders are more profitable when they trade against long-term investors than when they trade with other high frequency firms.

Hirschey (2013) has "evidence consistent with HFTs being able to anticipate order flow from other investors." Johnson et. al. (2013) "uncovered an explosion of UEEs [ultrafast extreme events] starting in 2006, just after new legislation came into force that made high frequency trading more attractive." Kim and Murphy (2013) found market spreads were much worse than have been reported. Kirilenko and Lo (2013) concluded that "In contrast to a number of public claims, high frequency traders do not as a rule engage in the provision of liquidity like traditional market makers." McInish and Upton (2012) "show empirically that latency differences allow fast liquidity suppliers to pick off slow liquidity demanders at prices inferior to the NBBO" and wrote that "the ability of fast liquidity suppliers to use their speed advantage to the detriment of slow liquidity demanders...unambiguously lowers market quality." Menkveld and Zoican (2014) found that "a faster market implies more interaction among HFTs, i.e., their market participation increases and, more importantly, transaction cost for 'low frequency' investors increases as a result."
Nanex (2013) detailed episodes where high frequency traders paid for market-moving information worth millions ahead of other investors. Nanex (2014) analyzed the impact of one trader's order and found "sell orders simply disappeared before the exchanges processed his buy order." Nasdaq (2012) "observed that upon partial execution of a routable order at NASDAQ...market participants often react to the order by cancelling their orders on other markets and entering new orders at inferior prices." (In 2014, a senior executive of a high frequency market maker, who is also head of an industry lobbying group, wrote "If I quote on 8 exchanges and get hit on one, I will update 16 prices. That is main reason for high [cancel] rates," strong evidence for Nanex's and Nasdaq's points; he later confessed "market makers offer more liquidity than they're prepared to trade in one go.") Norges Bank Investment Management (2013), one of the largest funds in the world with nearly $1 trillion under management, concluded that "issues of concern to large, long-term investors more deserving of attention include — Anticipation of large orders by some HFTs leading to potential adverse market impact — Transient liquidity due to high propensity for HFTs to rapidly cancel quotes real-time — Un-level playing field amongst market makers from low latency ultra HFT strategies."

Pragma Securities (2012) examined U.S. stock trading in 2011 and 2012 and concluded that "high frequency traders' ('HFTs') profits come at the expense of investors." The Quantitative Services Group (2010) examined U.S. equity data and reported that "Sophisticated pattern recognition algorithms now present a real return burden to active equity managers." Rogers et. al. (2014) found that the SEC provided corporate filings to high-speed traders before providing them to the public. Tong (2013) found "strong evidence that HFT increases the trading costs of institutional investors." Toulson (2013) examined European equities and found that HFT firms reacted to asset manager orders by cancelling their own orders and trading in front of the asset manager.

The United States Securities and Exchange Commission (2014) fined a high frequency trading firm for manipulating "the closing prices of thousands of NASDAQ-listed stocks" over a six month period; it levied a record fine against a stock exchange in 2015 for giving "information about order types only to some members, including certain high-frequency trading firms that provided input about how the orders would operate." Van Kervel (2014) found that "high-frequency traders can observe the first part of the trade and quickly cancel outstanding limit orders on other venues before the second part of the trade arrives." Ye et. al. (2013) concluded that speed improvements do not improve spreads but do increase cancellations and volatility.
Government Reaction to HFT

Central Banks

"The Growth of High-Frequency Trading: Implications for Financial Stability"
William Barker and Anna Pomeranets, Bank of Canada, June 2011
"[W]hile the growth of HFT has been associated with market-wide benefits, it also magnifies certain risks, which may cascade into financial systems and lead to financial instability."

"How to Keep Markets Safe in the Era of High-Speed Trading"
Carol Clark, Federal Reserve Bank of Chicago, October 2012
"A number of recent technology-related snafus have focused attention on high-speed trading and affected investor confidence in the markets. These incidents and the resulting losses highlight the need for risk controls at every step of the trading process."

"Market Structure, incentives, and fragility"
Carol Clark, Federal Reserve Bank of Chicago, March 2014
"Certainly, HST [high speed trading] poses operational risks to the market due to the rate at which large, unintended positions can accumulate. There is also the possibility HST may result in positive or negative feedback loops caused by a runaway algorithm triggering other algorithms or by numerous HST firms utilizing trading models that do not accurately assess and respond to changing market conditions. The myriad of technologies that support HST also result in 'systems that are robust yet fragile.' Failure in one of many parts may have unexpected knock-on effects in others."

"High-frequency trading in the foreign exchange market"
Guy Debelle, Reserve Bank of Australia, October 12, 2011
"While HFT generates increased activity and narrower spreads in normal times, it may have reduced the resilience of the system as a whole in stressed times by reducing the activity of traditional market participants who may have otherwise been an important stabilising presence in volatile environments."

"CFTC Concept Release on Risk Controls and System Safeguards for Automated Trading Environments"
Charles Evans, President and CEO, Federal Reserve Bank of Chicago, December 2013
"[W]e believe it would be prudent to require consistent risk controls for ATSs and high frequency trading (HFT) systems due to the speed at which each of these systems can amass large, unintended positions....We also note that many industry and regulatory groups have devised best practices for HFT. Nevertheless, many firms do not fully implement these best practices because they are not required to do so. We believe it would be beneficial for the Commission to work with the industry to define best practices for HFT and to communicate penalties for non-compliance with those best practices."

"European Commission's Public Consultation on the Review of the MiFID - Eurosystem Contribution"
European Central Bank, February 2011
"In the last few years, automated trading, and in particular High-Frequency Trading (HFT), has experienced strong growth. Such a development may trigger a number of risks for orderly trading and for financial stability."

"Opinion of the European Central Bank of 13 December 2012 on high frequency trading"
European Central Bank, December 13, 2012
"[A]lthough AT practices [including high frequency trading] may have legitimate purposes, they might also jeopardise the liquidity and efficiency of financial markets, particularly in times of market stress, as they could disturb the normal functioning of the market and increase volatility, which would be contrary to the public interest."

"Race to Zero"
Andrew Haldane, Bank of England, July 8, 2011
"Far from solving the liquidity problem in situations of stress, HFT firms appear to have added to it. And far from mitigating market stress, HFT appears to have amplified it. HFT liquidity, evident in sharply lower peacetime bid-ask spreads, may be illusory. In wartime, it disappears."

"Recommendations for Equitable Allocation of Trades in High Frequency Trading Environments"
"Rather than propose solutions that might preclude specific HFT strategies, we propose to simply change the economics of the trading environment by modifying the criteria of order allocation priority and by discouraging certain questionable industry practices to strike a more equitable balance between the high frequency trading community and the investment management community."

"High-frequency trading and market implications - an assessment from a central bank perspective"
Dr. Joachin Nagel, Deutsche Bundesbank, July 4, 2012
"There are increasing signs, for example, that, especially in volatile market situations, HFT might prove to be tricky - in the sense of further destabilising the market."

"Electronic trading and financial markets"
Kiyohiko Nishimura, Bank of Japan, November 29, 2010
"Although the expansion of electronic trading has brought many positive effects, as noted, it also has its own negative side with respect to the proper functioning of financial markets."

Regulators

"New Species: How Market Participants Have Evolved in Financial Ecosystems"
Bart Chilton, Commissioner, U.S. Commodities Futures Trading Commission, February 1, 2011
"Mini-flash crashes occur all the time, too. More than once last year in futures markets and several times in stocks, runaway robotic programs disrupted markets and cost people money. One company lost a million dollars in the oil market in less than a second when an algo ran wild."

"OSC head leans to the negative about high-frequency trading"
Boyd Erman, The Globe and Mail, August 20, 2012
Interview of Howard Wetston, Chairman, Ontario Securities Commission (Canada)
"'We ask ourselves the fundamental question: Is this type of trading actually consistent with what we expect of financial services and financial markets?'"

"New rules for high-frequency trading"
Federal Financial Supervisory Authority (Germany), November 22, 2012
“High-frequency trading has increased the speed and complexity of trading. This is associated with risks: for example, large order volumes may place a heavy burden on trading systems. Algorithms may also react to market events and trigger additional algorithms as a result, which may in turn trigger even more algorithms (cascade effect), leading to an increase in volatility.”
"Speed limit for high-frequency trading - Federal Government adopts legislation to avoid risks and prevent abuse in high-frequency trading"
Federal Ministry of Finance (Germany), September 26, 2012
"Computer-based high-frequency trading using algorithms poses multiple risks of extreme and irrational price fluctuations, overloaded trading systems and new opportunities for abuse."

"France wants tougher HFT regulation"
Jeremy Grant and Philip Stafford, Financial Times, December 19, 2011
Press conference of Thierry Francq, secretary-general of Autorité des Marchés Financiers (France)
"Mr Francq called for the creation of a 'preventive framework' of new market rules to 'minimise the risk of HFT, and that means probably a rather harsh slowdown of this technique.'"
See also "Issues related to MiFID II".

"Keynote speech by Jean-Pierre Jouyet"
Jean-Pierre Jouyet, Chairman of the Autorité Des Marchés Financiers (France), February 13, 2012
"More generally, high-frequency algorithmic trading can aggravate the instability of a market by provoking unfounded price oscillations or anomalies arising from the interaction of two algorithms, as we saw with the Wall Street flash crash of May 6th 2010."
See also "Issues related to MiFID II".

"ASIC Chairman's address to FINSIA Conference 2012"
Greg Medcraft, Chairman, Australian Securities and Investments Commission, October 10, 2012
"And while some say high-frequency trading provides liquidity, I know some very senior bankers that privately describe it as providing only 'phantom liquidity.'"

"Remarks Before the Investment Company Institute's General Membership Meeting"
Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission, May 6, 2011
"High frequency traders turned what was a very down day for many investors into a very profitable one for themselves by taking liquidity rather than providing it."

"Remarks before Trader Forum 2014 Equity Trading Summit"
Kara M. Stein, Commissioner, U.S. Securities and Exchange Commission, February 6, 2014
"Firms with direct access to the markets and execution venues should be required to have detailed procedures for testing their systems to ensure that they don't cause market failures. Systems should be reliable, so that anticipated failures are rare. Testing should be thorough. Data should be verified. But systems must also be resilient, so that they can adapt and respond to challenges. Seamless backup systems should be established. Firewalls and trading limits should be clearly defined and coordinated across markets."

"OFR 2013 Annual Report"
"Automated trading represents a significant portion of daily equity and foreign exchange volumes and a sizable portion of Treasury market volumes. Given these volumes, high-frequency trading poses several potential financial stability risks, suggesting that closer monitoring may be warranted...high-frequency trading systems may obscure price discovery, exaggerate illiquidity, increase volatility, and contribute to extreme price changes. The initial trigger may be a loss by a large institution that leads to a market disruption, with a cascading effect on markets and market participants. "
"OFR 2014 Annual Report"
"Historically, stock markets relied on intermediaries known as market-makers and specialists who are expected to buy and sell a particular stock at a publicly quoted price to maintain fair and orderly markets. Today, their role has significantly diminished as newer market participants, using high-frequency trading strategies, have emerged. Firms using high-frequency trading strategies are an important liquidity source under normal conditions, but do not have an explicit obligation to provide liquidity during times of stress. The so-called flash crash in equity securities on May 6, 2010 is one such example."

"FSOC 2014 Annual Report"
U.S. Treasury, Financial Stability Oversight Council, May 2014
"In the past year, there were several disruptions in market infrastructure systems that are designed to facilitate the transmission of data and support other automated trading systems....The Council also recognizes that alternative trading venues and methods may present operational and other risks by magnifying system-wide complexity. These vulnerabilities may be heightened, particularly in fragmented markets, by high frequency or low latency automated trading activities. As such, regulators should focus not only on centrally-traded products, but also on a broader set of financial products and trading methods that trade off exchanges."

"We need rules to limit the risks of superfast trades"
Martin Wheatley, CEO, Hong Kong Securities and Futures Commission
Financial Times, September 20, 2010
"When a single strategy becomes as dominant as HFT appears to have become - as happened in 1987 with ‘portfolio insurance’ and as is happening now with HFT - markets become fragile. And this fragility will lead to more shock events such as the ‘flash-crash’."

"Enhancing Our Equity Market Structure"
Mary Jo White, Chairman, U.S. Securities and Exchange Commission, June 5, 2014
"An area of particular focus is the use of aggressive, destabilizing trading strategies in vulnerable market conditions, when they could most seriously exacerbate price volatility. While the volatility moderators already put in place impose outside limits on price moves, even moves within those limits can be damaging. Instability arising during a broad market event may simultaneously affect hundreds or thousands of stocks, triggering many trading pauses and reopenings over a short period of time."

Legislators

"Tougher rules to protect investors and curb high-frequency trading"
European Parliament, October 26, 2012
"MEPs also tightened up proposed rules on high-frequency trading."

"MiFID: European Parliament wants safer financial markets"
"The new EU Directive on Markets for Financial Instruments (MiFID) ought to ban destructive speculation on financial markets."

“Harkin: Tax high-speed traders to fill budget hole”
U.S. Senator Tom Harkin interviewed by Ronald D. Orol of MarketWatch, November 29, 2012
“I really don’t see any evidence that these high-speed traders add anything to the economy, but they do also create some aberrations in the market that have led to some disturbances.”

"Ongoing Market Structure Review"
U.S. Senator Edward E. Kaufman, August 5, 2010
“For example, while speed and efficiency can produce certain benefits, they have also created a micro-arms race that is being waged in our public marketplace by high frequency traders and others.”

"Kaufman Delivers Final Senate Floor Speech on Market Structure Issues, High Frequency Trading"
U.S. Senator Edward E. Kaufman, September 28, 2010
"Simply put, technological developments must operate within a framework that ensures integrity and fairness.”
See also "Archived Web Site (captured November 2010) of Ted Kaufman (U.S. Senate, 2009-2010)".

"Request for Comments Regarding Findings and Recommendations of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues"
U.S. Senator Carl Levin. April 8, 2011
"Regulations designed to ensure the stability and integrity of our markets must be coordinated across all of the markets, and while the recent coordination by the SEC and CFTC is a useful step, I believe much more needs to be done.”
See also "Statement of Sen. Carl Levin - Subcommittee on Securities, Insurance and Investment".

Letter to U.S. Commodity Futures Trading Commission Chairman Gary Gensler
"The 2010 Flash Crash in equity markets severely damaged confidence and sent a signal to ordinary investors that they are at a disadvantage. If high-frequency traders are now causing similar crashes in the commodity markets, both the investment community and the general public will lose confidence that the markets are working properly.” See also letter to Elisse B. Walter, U.S. Securities and Exchange Commission and "Markey: Rules of Road Needed for Wall Street's High Speed Trading".

"Senator Jack Reed: Market Disruptions Are ‘Wake Up Call’ on HFT"
U.S. Senator Jack Reed interviewed by Lee Pacchia, Bloomberg, September 20, 2012
"I think we need much more emphasis on what's going on. I think we have to look very carefully. We've had some wake up calls - the flash crash, the situation with the Facebook public offering - and so we've been put on notice we have to look."

"SCHUMER TO SEC: IMPOSE TOUGHER RULES ON HIGH-FREQUENCY TRADERS TO CURB STOCK PRICE VOLATILITY AND PREVENT ANOTHER FLASH CRASH"
U.S. Senator Charles E. Schumer, August 11, 2010
"This disappearance of high frequency traders and their withdrawal of liquidity reveal a serious problem with our market regulation.”
See also "SCHUMER TO SEC: SLOW DOWN HIGH-FREQUENCY TRADERS WHEN MARKETS GET VOLATILE; SENATOR ALSO CALLS FOR PROBE INTO 'QUOTE STUFFING,' POSSIBLE BAN ON SUB-PENNY BIDS"

Prosecutors

"Cracking Down on Insider Trading 2.0"
"Remarks on High-Frequency Trading and Insider Trading 2.0"
Eric T. Schneiderman, New York Attorney General, March 18, 2014
"It is up to those of us who regulate and who enforce the securities laws to deal with the fact that these traders are now benefiting from special, early access to information that can’t be used the same way by the rest of the markets....One of the worst problems we’ve discovered as we’ve looked at this over the last year is the tendency for our markets and institutions to start catering to high-frequency traders, and becoming enablers of this particularly dangerous type of trading."

Other

"High-Frequency Trading: Background, Concerns, and Regulatory Developments"
Congressional Research Service, June 19, 2014
"This report provides an overview of HFT in the equities and derivatives markets regulated by the SEC and the CFTC. It also examines the Flash Crash of 2010 and the role that HFT may have played, as well as recent regulatory developments."

"ESRB response to the ESMA Consultation Paper"
European Systemic Risk Board, September 21, 2011
"There is also a growing concern that the expansion of HFT might undermine investor confidence and their willingness to participate in the markets."

"Position Paper"
Securities and Markets Stakeholder Group, European Securities and Markets Authority (ESMA), October 26, 2011
"On one hand, studies demonstrate that HFT firms are also active during times of crises, but on the other hand, they also found that when volatility is rising, HFTs increase their demand for liquidity, while decreasing their supply of liquidity."
High Frequency Trading Defined

Definitions of “high frequency trading” (HFT) can vary, but every definition published to date includes one common attribute: High frequency trading includes any business model or trading strategy where positions in the market are bought and sold quickly, often hundreds or even thousands of times a day. High frequency traders rarely hold on to a position overnight, and usually close a position within minutes or even within seconds.

Industry Participants

“The main innovation that separates high-frequency from low-frequency trading is a high turnover of capital in rapid computer-driven responses to changing market conditions.”

“While traditional buy-side trading strategies hold positions for weeks or even months, HFT is characterized by fast turnover of capital. Instead of capturing large price changes over extended periods of time, HFT aims to book multiple small gains over short periods of time. An overwhelming 86% [of survey respondents] believe that the term ‘high-frequency trading’ referred strictly to holding periods of only one day or less.”

“High frequency traders come from every kind of firm. Banks, investment funds, commodity trading advisors and proprietary trading firms all use computers to execute strategies that turn positions over frequently.”

“High frequency trading is best understood as a subset of algorithmic trading that is characterized by high levels of messaging deployed in a very low latency infrastructure as well as high turnover with short holding periods.”

“High-frequency trading is a method of trading that involves frequent turnover of positions, not a strategy in itself.”

“High-frequency traders (a) require a high-speed trading infrastructure, (b) have investment time horizons less than one day, and (c) generally try to end the day with no positions whatsoever.” (Emphasis in original.)

Academics

“HFTs are identified as those firms with extremely high volume, low intraday inventory and low overnight inventory....HFT firms stand out as a distinct cluster, with daily trading volume orders of magnitude higher than other traders.”
Baron, Brogaard, Kirilenko, “Risk and Return in High Frequency Trading” (2014).

“HFT is a type of investment strategy whereby stocks are rapidly bought and sold by a computer algorithm and held for a very short period, usually seconds or milliseconds.”

“[HFT] is generally defined as the rapid and continuous buying and selling of a financial asset while taking only small intraday positions and ending the day with no inventory.”
“HFT is the combination of low-latency connectivity, short holding periods and low inventory positions.”

“High frequency traders submit and cancel a massive number of orders and execute a large number of trades, trade in and out of positions very quickly, and finish each trading day without a significant open position.”
Cvitanic, Kirilenko, “High Frequency Traders and Asset Prices” (2010).

“Indeed, the typical high frequency market maker turns over his or her inventory 5 or more times a day, explaining how high frequency firms have come to have such a high share of trading volume. These market makers also seek to hold very small or even zero inventory positions at the end of the session.”

“Like traditional intermediaries HFTs are central to the trading process, have short holding periods, and trade frequently.”

Regulators

“[H]F traders execute trades in matters of milliseconds on electronic order books and hold new equity positions possibly down to a ‘sub-second.’ HFT generally involves getting in and out of positions throughout the day with a ‘flat’ position at the end of the day.”

“Trading activities that employ sophisticated, algorithmic technologies to interpret signals from the market and, in response, implement trading strategies that generally involve the high frequency generation of orders and a low latency transmission of these orders to the market. Related trading strategies mostly consist of either quasi market making or arbitraging within very short time horizons. They usually involve the execution of trades on own account (rather than for a client) and positions usually being closed out at the end of the day.”

“We generally characterise HFT as automatically generating large numbers of orders based on price movements and market information, holding positions for a very short time, and ending the day with a zero position.”

“Other characteristics often attributed to proprietary firms engaged in HFT are...(3) very short time-frames for establishing and liquidating positions…”

“A number of common features and trading characteristics related to HFT can be identified...It is characterized by a high daily portfolio turnover and order to trade ratio (i.e. a large number of orders are cancelled in comparison to trades executed); It usually involves flat or near flat positions at the end of the trading day...Positions are often held for as little as seconds or even fractions of a second.”

“Other characteristics often attributed to proprietary firms engaged in HFT are...(3) very short timeframes for establishing and liquidating positions…”
"There is no widely accepted definition of HFT, but it typically exhibits some common characteristics, such as: (1) high volume of trades on a daily basis but low level of profits per trade; (2) extreme short stock holding period (I know of one HFT firm operated out of the west coast of the US that boasts its average holding period for US equities is 11 seconds); (3) submitting numerous orders; and (4) no significant open position overnight."

"The attribute that most clearly characterises high-frequency trading and differentiates it from other trading is the percentage of turnover bought and then sold, or sold and then bought, within each trading day. High-frequency traders tend to close out a high proportion of trading intraday, so their overnight positions are relatively small. This metric distinguishes high-frequency trading from the more widespread execution algorithms which trade in only one direction during a day."
Australian Securities and Investments Commission, "Report 331: Dark liquidity and high-frequency trading" (2013).

"HFT typically refers to the use of computerized trading to move in and out of positions rapidly, generally ending the day flat with little or no exposure to the market on an overnight basis."
Dear [Name]

I hope everything is ok

In case of interest I enclose the presentation of [Name] at Ceps last week on Supervision in the EU

See you soon and in the meanwhile Merry Easter

[Signature]
The third meeting will discuss the legal and institutional underpinnings of a capital markets union.

10:00h    Registration

10:30h    Introduction by Rapporteurs and Chairman, plus tour de table.

10:40h    Session 1. Insolvency proceedings for transactions in financial instruments: does an EU framework exist?

A cross-border transaction in financial instruments may become very complex when it comes to enforce a claim when one of the counterparts fails to pay. What is the current situation today of cross-border insolvency proceedings? What can the EU do more to remove this major obstacle?

Speaker: Bob Wessels, Professor of International Insolvency Law, University of Leiden
Discussant: Caro van den Broeck, Institute for Commercial and Insolvency Law, KU Leuven

11:10h    Discussion

12:00h    Session 2. Defining the border between regulatory competition and harmonisation in EU securities law

Rules on collateral management, netting, security ownership are only some of the areas where national securities laws still diverge. Which of these differences can be priced in and in which direction should further harmonisation be directed?

Speaker: Raj S. Panasar, Cleary Gottlieb Steen & Hamilton LLP
Discussant: TBC

12:30h    Discussion

13:00h    Lunch
14:00h  Session 3. Supervision in the era of capital markets union

Is the institutional framework and legal status of ESMA fit for purpose? Can ESMA ensure convergence of supervisory practices? What is the relationship between the agencies and the judicial system? Is the judicial review of European law working properly? Will EU case law promote greater harmonisation? What is the link between CMU and banking union? Can we expect conflicts with the ECB Single Supervisory Mechanism on financial stability ground?

Speaker: Marco Lamandini, Bologna University
Discussants: Nicolas Véron, Senior Fellow, Peterson Institute & Bruegel; Carmine Di Noia, ASSONIME

14:30h  Discussion

15:10h  Coffee break

15:30h  Session 4. The eternal quest for common accounting standards: how can we get comparable data in the EU?

Why are accounting data still not fully comparable across Europe and what can EU institutions do if full harmonisation is a dead end? Is a partial application to listed companies making things worse? How is gold plating looking like?

Speaker: Christian Leuz, Chicago Business School; Evelyn Bunn, KPMG
Discussants: Françoise Flores, EFRAG; Nicolas Véron, Senior Fellow, Peterson Institute & Bruegel

15:50h  Discussion

16:20h  Wrap-up and conclusions

16:30h  End of the meeting
Supervision in the era of Capital Markets Union (CMU)

Marco Lamandini
Alma Mater Studiorum Università di Bologna

ECMEG - Bruxelles 16 March 2015
Our agenda

a. The current policy debate: what is politically feasible is also sufficiently forward looking?

b. Possible implications on legal architecture of the ECJ “ESMA shortselling” judgment in the case C-270/12; but shall any real change be politically viable?

c. CMU as a catalyst for institutional change: the existing weaknesses of the ESFS and the centrality of uniform implementation and better enforcement of the single rule book;

d. Scalability of institutional cooperation and European multilevel supervisory governance;

e. A possible road map for an ambitious ESFS reform within the CMU: a 5 legs program.
Why a debate on a mid term evolution of the ESFS could gain momentum? (a) policy making: (i) the prudent view

A soft approach from the Commission, so far:

A. Green Paper “Building a Capital Markets Union” (2015): “Although regulatory frameworks for capital markets have largely been harmonized, the success of reforms also depends on the implementation and consistent enforcement of the rules. The ESAs play a key role in promoting convergence”

B. Report from the Commission “on the Operation of the ESFS” (2014): “Possible extensions of the current mandates should be thoroughly assessed in the light of the subsidiarity principle and against costs and benefits. Potential areas for further tasks to be assigned to the ESAs concerned could include the area of IFRS enforcement, a stronger oversight role on internal model validation, shadow banking and direct supervision of highly integrated market infrastructure such as CCPs”
Why a debate on a mid term evolution of the ESFS could gain momentum? (a) policy making: (ii) the more “visionary” approach

Three forces could push towards a more ambitious redesign:

A. **policy makers**: a wider and more straightforward call for ESFS reconsideration from the European Parliament (see EP Study October 2013 – IP/A/ECON/ST/2012-21 PE 507.446);

B. **markets**: the drive towards an integrated Capital Market Union could call for streamlined supervision of cross border transactions and operations to cut transaction costs and remove hidden barriers;

C. **euristics**: the US SEC and Banking Union SSM models might be conducive to a similar path of evolution for Europe.

A fourth undesired “phantom of the opera” in the backstage: scandals related to market and/or institutional failures on cross border investment matters could suddenly exacerbate the need for a more thorough reform and...
And ... (b) legal implications from the “Esma short selling” case have meanwhile modified the understanding of Treaty limits

- Law matters! There might be institutional implications from the ECJ landmark decision in case C-270/12 “ESMA short selling”:

  the Meroni and Romano doctrines were “reinterpreted” (and partially repealed?) by the ECJ in light of the Treaty of Lisbon (where EU agencies are mentioned in about 27 provisions); the Court recognized the legality of the delegation of binding powers and discretionary competences to European Union entities other than the Commission, if (i) the entity is created by the EU legislature (§ 43), (ii) delegated powers are circumscribed by conditions and criteria limiting discretion (§ 45): (iii) the exercise of the delegated powers is subject to judicial review (§ 53). This applies both to individual decisions and measures with general application.

- The ruling could imply that:
  (1) Article 114 TFEU is a sound legal basis for the EU legislature to establish a full fledged supervisory agency enjoying discretionary powers, herein included individual binding powers, provided that no policy choices are delegated;
  (2) the Union entity can in principle adopt binding individual decisions or measures with general application without the need of a formal endorsement by the Commission under Articles 290 and 291 TFEU.
CMU could act as a catalyst for institutional change and help removing some of the existing weaknesses of the ESFS

Recognized weaknesses of the existing institutional setting (a non exhaustive list in line with the Commission Report):

a. **governance**: national views rather than EU-wide interests dominate the decision making process within the BoS/too weak a role for the Chair, the Executive Director and Management Board/role and transparency of the JC and of the SG should be strengthened

b. **supervisory coordination**: greater use is needed for peer review, for the work of colleges of supervisors (established also for CCPs since September 2013), for binding mediation and for the proceedings under Article 17 for breach of Union law

c. **consumer protection**: article 9 is too restrictive because it is conditional (can be exercised if the sectorial legislative acts of Article 1(2) provide it); the horizontal nature of consumer protection requires more role for JC

d. **budget**: existing budgetary constraints limit the ability to adequately staff the ESAs
Calls for reform of the ESFS from market participants:

(a) NYSE Euronext view

Many respondents to the consultation 2013 focused on ESMA with interesting remarks (see e.g. ICMA, IMA, SSDA, Moody’s, FSCP, EACH, EFAMA). Consider at least:

**a. NYSE Euronext**: “NE is a strong proponent of an effective cross-border and EU-wide system of financial services supervision. This position stems from the core cross border nature of the group. Since the creation of Euronext in 2000, our trading platforms have been supervised collectively by a College of Regulators. Harmonization of rules – where possible – has been one of the key goals of Euronext since its inception, focusing on the creation of a single equities order book and cross border access to our markets”. For the future NE calls for:

i. prioritization of consistent application of the regulations and developing convergence of supervisory practices, to bring about uniform procedures and consistent approaches throughout the Union, also making wider use of binding mediation and powers under Article 17 and allowing ESMA binding opinions on the actions of NCAs (note however that, albeit acknowledging the merit for some selective ESMA direct supervision - also on administrators of financial benchmarks, NE supports decentralized direct supervision): NCAs are closer to the day-to-day operations and have expertise and experience to conduct front line supervision. Moreover there is still a national fiscal responsibility for failures of national entities;

ii. enhancements of ESMA role in the global convergence and international coordination;

iii. increase in the funding resources and more transparency on the rationale for ESMA’s chosen priorities;

iv. more focus on consumer protection with more product warnings and greater monitoring of new and existing financial activities to promote regulatory convergence on retail products.
Calls for reform of the ESFS from market participants: 
(b) Assonime view

b. Assonime:

i. “it is absolutely necessary to empower only one ESA of investor protection for all financial sectors”, with a move towards a “3-peaks model” designed by objective. “Our proposal assigns macro-stability to the ESRB with the support of ECB, and the other two objectives of prudential regulation and investor/consumer protection to two new ESAs: the European Prudential Authority in charge for the regulation of micro stability for all entities (banks, UCITS, investment firms, insurance firms) working in close cooperation with the SSM; The European Investor Protection Authority in charge for all transparency issues and business conduct rules and supervision on all entities and markets”;

ii. existing limitations on the scope of ESMA competences only to the topics listed in Article 1(2) should be overruled with an extension of the powers under Articles 10, 15, 17 and 19 also on the matters listed in Article 1(3);

iii. express endorsement by the Commission of RTS and ITS should be supplanted by tacit approval;

iv. internal governance must be reformed along the lines of the ECB executive board (six independent members appointed by the European Council) with casting vote in both BoS and MB of the Chair.
Existing weaknesses of the ESFS from the Board of Appeal experience

a. **Breach of Union law proceedings under article 17**: they are open either upon request from NCAs, EP, Commission, SG, or “on own initiative”. Once there is a call for action from market participants, the ESAs enjoy wide technical discretion on whether to act on own initiative or not and the quasi judicial review of such decision proved so far difficult to obtain (BoA 18 July 2014, *SV Capital v. EBA II*, showing significant self restraint; but for the suggestion that a review of the decision under the max.mobil standard must be ensured, BoA, 10 November 2014, *IPE v. ESMA*). The use of Article 17 has been timid so far (also for governance weaknesses related to the dominating role of NCAs) and internal rules of procedure justify this, e.g. when action is taken or is likely to be taken at national level. If there is a beggar thy neighbor supervisory competition (as it has been claimed in the IPE case, suggesting that also national courts were excessively lenient), the “own initiative” barrier could make it more difficult to obtain the use article 17 as an effective redress to bring about a CMU level playing field.

b. **Guidelines and recommendations**: they enjoy “a soft law plus” status (see BoA, 24 June 2013, *SV. Capital v. EBA I*, where reference is made to guidelines on fit and proper for bank officials). They often regulate fields not covered by RTS or ITS. In principle recommendations and guidelines are excluded from ECJ review under article 263 TFEU. They can however become “de facto binding” (Lamandini, 2011; EFAMA, 2013). They should be at least reviewable by the BoA (see also Commission Report, p. 5-6, admitting that where they are intended to produce legal effects vis-à-vis third parties they should be subject to review and that the matter is unresolved under the ECJ case law yet).

c. **Standards of review**: The BoA 10 November 2014 distinguished between “appeals” to the Board (implying wider consideration of the merit) and review of the ECJ (limited to legality). The BoA, 10 January 2014, *Global Standard Rating v. ESMA*, shows the kind of (merit) review that can be expected by the BoA. Considered the ECJ standard of review (“Remia plus”) currently applied to discretionary technical decisions, it is quite unclear to what point quasi judicial and judicial standards of review differ. It is also unclear, from the reading of article 60(1)-(2) whether access to the ECJ is conditioned or not on the preliminary exhaustion of quasi judicial review.
CMU and “progressive” institutional change: first priority is now uniform implementation and better enforcement

- **A golden rule**: Progressivity and scalability have always been, and are likely to be, the “mantra” for institutional re-design. And rightly so. The multilevel governance for CMU supervision is a matter of well-balanced composition and a dynamic flux of institutional adjustments.

- However, uniform implementation and better enforcement is key

- “Given the complexity of the challenges, a CMU program will be difficult to delineate. Much depends on the level of ambition and the objectives pursued. The first priority should be complete the single market to achieve more depth, breadth and scale. Considering that many measures were adopted during the financial crisis that create the regulatory framework for the different actors in capital markets, enforcement is the key task. And that’s where the analogy with the Banking Union arises (...) But can ESMA cope and does the structure for cooperation work? This is where the Review of the European Supervisory Authorities comes in”

- (K. Lanoo, *ECMI policy brief*, 2/2015, p. 6)
Institutional cooperation within the existing architecture: where do we stand now?

Cooperation from “small” to “extra large”!

<table>
<thead>
<tr>
<th>Degree of Europeanization</th>
<th>S (small)</th>
<th>M (medium)</th>
<th>L (large)</th>
<th>XL (extra-large)</th>
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<tbody>
<tr>
<td><strong>Institutional Structure</strong></td>
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<td>EU agency or an Institution of the European Union (European Central Bank)</td>
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<tr>
<td>(In)formal network comprising representatives of relevant national public authorities (and stakeholders)</td>
<td>EU agency (a body enjoying legal personality) comprising representatives of relevant national public authorities (and stakeholders)</td>
<td>More involvement of the Commission and the European Parliament in the governance structures, e.g., in the appointment and removal procedures of agencies’ top-level officials</td>
<td>Hierarchical division between the EU and national levels’ powers in emergency circumstances</td>
<td>Hierarchical division between the EU and national levels’ powers with a possibility to issue instructions to national supervisors</td>
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<tr>
<td><strong>Legal powers</strong></td>
<td>Non-legally-binding decisions</td>
<td>Non-legally-binding decisions but advice to the Commission</td>
<td>Legally-binding powers in certain circumstances</td>
<td>Legally-binding powers concerning certain policy fields</td>
</tr>
<tr>
<td><strong>Elements Promoting Shared Enforcement</strong></td>
<td>- Giving non-binding recommendations</td>
<td>In addition to the possibilities under the ‘S’ model: - Possibility to issue legally-binding enforcement decisions overruling national authorities via the Commission - Possibility to issue binding decisions in mediation and conciliation procedures to enhance compliance</td>
<td>In addition to the possibilities under the ‘M’ model: - Possibility to issue legally-binding enforcement decisions overruling national authorities directly</td>
<td>Direct supervision and sanctioning at the EU level with a reliance on national supervisors</td>
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<td></td>
<td>- Enhancing information exchange, establishing central databases and promoting the exchange of best practices</td>
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<td>- Developing common standards to measures and comparing enforcement regimes, conducting peer reviews</td>
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<td>- Mediating disputes on a non-binding basis</td>
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<td>- Identifying problem areas, differences and common goals</td>
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<td></td>
<td>- Providing opinions to the EU institutions</td>
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<tr>
<td><strong>Challenges to Effective Enforcement</strong></td>
<td>- Impossibility to enforce its non-legally binding recommendations/s no sanctions against non-compliance to follow recommendations, guidelines and requests to cooperate</td>
<td>Differences in the implementation and enforcement of recommendations and decisions of the EU agency due to legal, political and cultural differences in the MSs</td>
<td>(De jure) ignoring of the differences between national enforcement laws and practices which may adversely affect enforcement in individual MSs</td>
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An ambitious way forward for ESFS within the CMU: a possible road map

To my mind, to improve effectiveness five guiding principles should orientate the dynamic “rebalancing” exercise of the supervisory architecture within the CMU:

a. direct and broader scope delegation of regulatory and technical standard setting to the ESAs and a better clarification on the role of guidelines and recommendations;

b. a mix of centralised and de-centralised supervision with no blind mimicking of the SEC or SSM models (a European CMSS);

c. ESAs new governance should ensure that EU-wide interests dominate in the decision making process;

d. a cross sectorial approach invites a structural reconsideration of the allocation of competences and investor protection must be fostered;

e. a reinforced judicial and quasi judicial review system should better ensure legality and due process in the enforcement exercise (herein included sanctions).
An ambitious way forward for ESFS within the CMU:
(a) direct and with broader scope delegation of RTS and ITS
and clarification on guidelines

The more the EU Commission claims, and with some merit, a political role, the less reliance
should (and could) be made on Articles 290 and 291 TFEU: it is always difficult for an institution
to “wear two hats” (political and technical) and the ECJ was crystal clear in saying: “no policy
choices beyond this point”!

a. “Regulatory” delegation should be made to the ESAs through appropriate amendments to the
deleagating legislative acts under the “Esma shortselling” ruling, providing for needed checks and
balances (a veto power for the Commission and the co-legislators?) and full accountability;

b. Scope of the RTS and ITS standard setting should be widen beyond article 1(2), to encompass
also 1(3) subject-matter;

c. Legal clarification is needed on scope of guidelines and recommendations, on whether should be
limited to giving guidance on how to interpret existing EU primary and secondary rules with a
view to ensure “common, uniform and consistent application of Union law” or could expand to
issue additional layers of quasi-regulation (see ESMA guidelines on ETFs and other UCITS issues
of 18 December 2012)
An ambitious way forward for ESFS within the CMU: (b) a mix of centralised and decentralised supervision with no blind mimicking of the SEC and SSM models (the CMSS)

I would advocate for a three legs model for a new European capital markets supervision system (CMSS), going a further step beyond the existing cooperative network of NCAs and ESMA current entitlements:

1. **centralised ESMA supervision for pan European market operators** (CRAs, Trade Repositories; in due course Data Monitors under MiFID2 and Benchmark Operators, and perhaps even CCPs, consolidated Stock Exchanges, proxy advisors?);

2. **joint supervision for cross border transactions** (currently CCPs, cross border Stock Exchanges and trading venues; in due course multiple listing, cross border takeovers, cross border prospectuses for issuers, UCITS and AIFs) through colleges of supervisors including ESMA with voting right and with the option for the market player to opt for a EU- wide direct supervision of ESMA;

3. **upgraded and converging home country supervision for national transactions and prudential supervision** through a more proactive use of peer review, guidelines and recommendation as well as Article 17 proceedings by ESMA.
An ambitious way forward for ESFS within the CMU: (c) a new governance for ESMA

ESMA governance should ensure that EU wide interests dominate in the decision making process:

1. The Management Board should be composed in a way similar to the board of the Single Resolution Mechanism in the Banking Union: Article 45 should be amended and the 6 members of the MB should be the Chair, the Executive Director and four additional independent members appointed by the European Commission (compare also Commission Staff Working Document accompanying the Report 2014, p. 6);

2. Chair and ED should be given voting rights in both the BoS and Management Board;

3. Enhancements of ESMA role in the preparatory standing committees, working groups and task forces as well as of the SG role;

4. Budget must be increased because ESAs are understaffed for CMU needs and more attention should also be given to language diversity principle (a costly fundamental right under the TFEU and regulation 1/58: see BoA, interim decision, 17 February 2015, *Onix Asigurari v. Eiopa*).
An ambitious way forward for ESFS:
(d) a structural reconsideration of the allocation of supervisory competences and improvements in investor protection

a. A cross sectorial approach invites a structural reconsideration of the allocation of competences: ESMA could (and perhaps, in due course, should) be given full competence over transparency and consumer protection across the entire financial sector. EBA and EIOPA would retain full competence over micro prudential regulation (and in due course the two could be merged into one single authority, sitting in London).

b. Even if nor structural re-allocation is envisioned, more action is needed on consumer protection.

1. Complete the half-way revolution of Article 9 on (dangerous) financial product merit review! Article 9 should be made a self standing provision of very general application and should be used correspondingly. Warnings under Article 9 must be made public in a more effective way (national newspapers? Compulsory written disclosure by the investment company to the client at the pre-contractual stage?)

2. Peer reviews, ESMA guidelines and Article 17 proceedings should be strongly promoted to curb supervisory competition in laxity by NCAs in prospectus review and other consumers/retail investors’ protection issues
An ambitious way forward for ESFS within the CMU: (e) a reinforced judicial and quasi judicial review system

A reinforced judicial and quasi judicial review system should better ensure legality and due process in the enforcement exercise (herein included sanctions).

a. BoA funding should reflect its increasing role: due to a rising tide of complex and ground braking cases, that help putting in the place the ESFS/CMSS, funding could be done mimicking that of a stable arbitration dispute resolution mechanism.

b. Application of monetary and non monetary sanctions has become a tricky institutional exercise requiring institutional adjustments: in the wake of the EuCHR decision 4 March 2014, *Franzo Grande Stevens* and ECJ, 26 February 2013, case C-617/10 *Aklagaren v. Akerberg Fransson*. To ensure due process and an equitable trial, it could be asked to the BoA (who is independent) to apply sanctions upon request of ESMA with full respect of the right of defense of the other party and the ECJ should be given full merit review under Article 261 TFEU (also on the amount of the fine).

c. Urgent clarifications are also needed to make clear:
   i. guidelines and recommendations are, and to what extent, reviewable, at least by the BoA;
   ii. the appeal review under article 60 is wider that the legality recourse to the ECJ under Article 263 TFEU;
   iii. ECJ *Reutgers case* applies, and to what extent, to RTS and ITS;
   iv. preliminary exhaustion of the internal review applies and to what extent;

d. provisions on the vertical cooperation between ESMA and NCAs and national judges since long applied in the antitrust sector under reg. 1/2003 should be adapted and applied here too.
Can CMU stand without a CMSS?

The Bank of England claims that CMU “does not require institutional change” and no super-regulator should be created. This is politically understandable but, technically, quite questionable. Moreover a CMSS is not a single super-regulator!

We know by now that, as usually taught by a former Senior Legal Counsel at the Commission, “the camel is an horse made in Brussels” ...

but if CMU is intended to go somewhere, it is difficult to deny that “at some point supervisory issues will pop up” (a prediction leaked in the press from Hill’s cabinet)
Thank you for your attention!

These are presentation slides only. The information within these slides does not constitute definitive advice and should not be used as the basis for giving definitive advice without checking the primary sources.
Supervision in the era of capital markets union

Comments by

ECMEG – Bruxelles
March 16th, 2015
## Financial regulation/supervision around the world

<table>
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<tr>
<th>Country</th>
<th>Banking</th>
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<th>Insurance/Pension fund</th>
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<td>UK (macro FPC)</td>
<td>PRA(CB) / FCA</td>
<td>PRA(CB) / FCA</td>
<td>PRA(CB) / FCA / PF</td>
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<td>SSM / EBA/CA</td>
<td>ESMA/CA</td>
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<td>Japan</td>
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CB (Central bank), PA (Prudential Authority on banks, securities and insurance, different from CB), B (Prudential Agency for banks), IP (Investor protection Authority for banks, securities and insurance), S (Securities Authority), I (Insurance Authority), PF (Pension Fund Authority), IPF (Insurance and Pension Fund Authority), FSA (Single prudential and investor protection regulator), G (Government department), CA (National Competent Authorities)
Financial Union: what’s in place

- 3 (cities?) micro-prudential (?) supervisory (?) authorities (?) (EBA, ESMA, EIOPA) and ESRB (macro-prudential). Increasing number of joint committee documents

- Banking

- Too late for having (regulation and) supervision ONLY at national level; too early to have supervision ONLY at the central/EU level
ESAs Review

New review of ESAs by January 2nd 2017 (2014+3?) (art. 81.2 ESAs Regulations). Appropriateness of separation of banking, insurance, securities and financial markets and separation of prudential supervision and business conduct; coherence in ESFS of macro and micro levels and between the ESAs; move ESAs to a single seat.

The EU Commission ESAs report identifies several areas for improvement: ESAs should give a higher profile to issues related to consumer/investor protection, and strengthen the focus on supervisory convergence, with better use of peer reviews. Long term: governance of the ESAs improve the capacity of the Board of Supervisors to take decisions in the interest of the EU as a whole.

ESMA SMSG Contribution on ESAs Review: Short and Long term proposals. Enlarging powers to areas of 1(3); no authorization of NCA for results of peer review; CG of ESAs; direct supervisory powers on all entities with EU-wide reach; ESAs in the treaty; twin peaks with microprudential outside (E)CB in London and Investor Protection in Paris.
ESAs Review – EU Parliament Resolution

- ESFS further adapted to the SSM
- Enhance powers of all ESAs to conduct stress tests
- Ensure ESAs, ESRB, NCAs and the ECB for SSM countries have access to the same supervisory information, provided where possible in the same frequency and a common electronic format which has to be determined by the ESAs
- Governance: transforming the Management Boards of the three ESAs into independent bodies, staffed by three professionals with a European mandate, appointed by Parliament, the chairperson of the ESAs and the executive directors; granting members of MBs right to vote on the BoS to ensure more independence from national interests. Bos: Heads of NCA and new MB
- Chairperson of Management Board shall coincide with Chairperson of BoS and have a casting vote both in MB and BoS.
- Enhancing investigatory powers of ESAs and introducing direct supervision of highly integrated pan European entities or activities
- Is current model of three separate supervisory authorities the best solution for coherent supervision;
24) In your view, are there areas where the single rulebook remains insufficiently developed?

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?

“Discussions on a 'pan-European securities law' date back more than a decade. This is a politically sensitive and complex subject as it touches on property, contract, corporate and insolvency law, as well as the laws on holding of securities and conflict-of-laws.”
An (old) proposal

Euro(pean) Financial Union

- Financial Union for EU countries (or opt-out for non euro countries; ECB can be a lender of last resort only for countries where it is the central bank)
- Federal model: central regulation; national supervision for all entities but cross-border and (even non banking) Sifi. Paneuropean Issuers and Offers
- Supervisory Standards and Single rulebook at central level.
- … 4-peaks (separating macro and micro stability, investor protection and competition) irrespective of the nature of intermediaries; cancel one ESA
- Governance of central agencies similar to ECB
- National coordination committees at national and central level with policy makers (and EU Commission)
- Change in the Treaty: mission impossible!
4-peaks with macrostability to ECB and ESCB and microstability: prudential regulation and supervision separated from (subsidiary?) ECB

**Euro(pean) Level**

- **Coordination Committee**
  - ECB (and ESRB) Frankfurt
  - European Prudential Authority London
  - European Investor Protection Authority Paris
  - European Antitrust Authority Bruxelles

**National Level**

- **Coordination Committee**
  - National Central Banks
  - Prudential Supervisory Authority
  - Investor Protection Authority
  - Antitrust Authority