European Commission - Fact Sheet

Questions and Answers on the Action Plan on building a Capital Markets Union

Brussels, 30 September 2015

What does the term 'Capital Markets Union' mean?

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 movement of capital is a long-standing objective of the European Union — a fundamental freedom at the heart of the single market. Despite the progress that has been made, Europe's capital markets remain fragmented along national lines and European economies remain heavily reliant on the banking sector for their funding needs. This makes them more vulnerable should bank lending tighten, as happened during the financial crisis.

The Action Plan published today sets out the priority actions needed to put in place the building blocks of a Capital Markets Union by 2019, removing barriers to cross-border investment and lowering the costs of funding. As part of the third pillar of the Investment Plan for Europe, the Capital Markets Union should help businesses tap into more diverse sources of capital from anywhere within the EU, make markets work more efficiently and offer investors and savers additional opportunities to put their money to workin order to enhance growth and create jobs.

What are the benefits of a Capital Markets Union (CMU)?

CMU will complement Europe's strong tradition of bank financing, and will help to:

- **Unlock more investment from the EU and the rest of the world:** the CMU should help mobilise capital in Europe and channel it to all companies, including SMEs, and infrastructure projects that need it to expand and create jobs. It will provide households with better options to meet their retirement goals.
- **Connect financing more effectively to investment projects across the EU:** the CMU is a classic single market project for the benefit of all 28 Member States. Those Member States with the smallest markets and high growth potential have a lot to gain from a better channelling of capital and investment into their projects. More developed market economies will benefit from greater cross-border investment and saving opportunities.
- **Make the financial system more stable:** by opening up a wider range of funding sources and more long term investment, reduce the vulnerability of EU citizens and companies to banking shocks such as those they were exposed to during the crisis.
- **Deepen financial integration and increase competition:** more cross-border risk-sharing, deeper and more liquid markets and diversified sources of funding should deepen financial integration, lower costs and increase European competitiveness.

Does the Commission envisage adopting legislative proposals?

The Commission has committed to three legislative proposals in the short term. Others may be needed in the medium term. In line with the Commission's Better Regulation principles (IP/15/4988), legislation will only be used where needed, and where it is the best tool for the job. For some areas, legislation might not always be the appropriate policy response, and the onus in many cases will be on the market to deliver solutions. Non-legislative steps and the effective enforcement of competition and single market laws might offer the best way forward in other areas. The Commission will support market-driven solutions when they are likely to be effective, and regulatory changes only where they are necessary.

What is the calendar for the implementation of this Action Plan?

The Action Plan sets out the actions that will be taken over the next years so that the building blocks of the CMU are in place by 2019.

Immediate Steps and Short-term Actions

The Commission is publishing its Action Plan today. It is also putting forward the following two immediate steps: one on high-quality securitisation and another on allowing more funding to flow to infrastructure projects. It is also launching three additional consultations - one on venture capital funds, another one on covered bonds, and a call for evidence on the cumulative impact of financial legislation.

Today the Commission is publishing:

- Legislative proposals to establish a framework for **simple, transparent and standardised securitisation** and to set out new prudential calibrations for banks in the Capital Requirements Regulation (CRR);
- An adjustment to the "Solvency II" legislation to make it **easier for insurers to invest in infrastructure** and European Long Term Investment Funds (ELTIFs);
- A consultation on how to build a pan-European **covered bond** framework;
- **A call for evidence on the cumulative impact of financial services reforms**, with the objective of assessing the interactions between rules and cumulative impact of the reforms adopted in the recent years;
- **A consultation on venture capital** to assess whether targeted changes to the regulations could boost the take-up of these investment funds.

By the end of the year the Commission will:

- Review the Prospectus Directive to reduce barriers to smaller firms listing on markets;
- Publish a Green Paper on retail financial services to boost consumer choice and competition in cross border retail financial services and insurance.

Longer term Actions

From 2016 and in subsequent years, the Commission will:

Supporting access to finance

- Support venture capital and equity financing
- Overcome information barriers to SME investment
- Promote innovative forms of corporate financing
- Strengthen access to public markets
- Support equity financing
- Support infrastructure investment

Increasing investment

- Increase choice and competition for retail consumers
- Support saving for retirement
- Expand opportunities for asset managers

Removing barriers to cross border investment

- Remove national barriers to cross-border investment
- Improve market infrastructure for cross-border investing
- Foster convergence of insolvency proceedings
- Remove cross-border tax barriers
- Strengthen supervisory convergence
- Enhance capacity to preserve financial stability.

More precise details and timetable are set out in the Action Plan.

1. New rules on securitisation

Securitisation refers to a transaction that enables a lender – often a bank - to refinance a set of loans/assets (e.g. mortgages, auto leases, consumer loans, credit cards, trade finance) by converting them into securities. The lender pools a portfolio of its loans into a set of securities tailored to different investor risk/reward characteristics. End investors are then repaid by the cash-flows generated by the underlying loans.

If soundly structured, securitisation can be an important channel for diversifying funding sources and enabling a broader distribution of risk by allowing banks to transfer the risk of some exposures to external agents (for example to non-bank financial agents such as insurance companies and asset managers). The proposal presented by the Commission provides for criteria which should help better differentiate simple, transparent and standardised (STS) products to support investor confidence and make it easier to carry out due diligence. Building on advice from the European Banking Authority (EBA), the Commission also proposes more appropriate prudential requirements for banks' investments in STS products. This should allow banks to clean up their balances sheets by freeing the part of their capital that had previously been set aside to cover for the risk, and therefore allow banks to lend more to the real economy, notably to SMEs. Also see Memo/15/5733.

2. Making it easier for insurers to invest for the long term (Solvency II)

Investment in infrastructure projects is essential for supporting economic activity and growth in Europe. Such projects require large, long-term sources of financing. The insurance industry is equipped to provide long-term finance by investing in equity shares as well as loans of infrastructure projects, and the Commission aims to incentivise the insurance sector to play a full role in European infrastructure projects. It asked for the advice of the European Insurance and Occupational Pensions Authority (EIOPA) on the creation of a distinct infrastructure asset category under Solvency II, the EU's insurance prudential framework.

The proposed legislation which modifies the Solvency II Delegated Regulation creates the right incentives for insurers to invest in infrastructure projects, in particular by reducing the amount of capital which insurers must hold against debt and equity of qualifying infrastructure projects. Also see Memo/15/5734.

3. Public consultation on venture capital

Small and medium-sized unlisted companies often find it hard to get mainstream financing via bank loans and they do not have access to capital via stock markets. The European Venture Capital (EuVECA) and European Social Entrepreneurship Funds (EuSEF) regulations set up two new types of collective investment funds to make it easier and more attractive for private savers to invest in unlisted SMEs. The new funds can be marketed to investors able to commit at least € 1 00,000, regardless of where they are based. The consultation will ask whether targeted changes to the regulations could boost the take-up of these investment funds. The consultation will look in particular at more technical issues such as the restrictions on who is able to manage the funds, the level of minimum investment of € 100,000 for investors and whether non-EU managers should be able to offer EuVECA or EuSEF funds. It runs until 6 January 2016.

4. Public consultation on covered bonds

Covered bonds are a cornerstone of long-term finance for many EU Member States as a key instrument to channel cheap finance to the property market and public sector entities. Covered bonds are debt obligations issued by credit institutions which offer a so-called "double-recourse" protection to bondholders: if the issuer fails, the bondholder has a direct and preferential claim against certain earmarked assets and an ordinary claim against the issuer's remaining assets. Covered bond outstanding volume in the EU reached €2.5 trillion in 2014, making European credit institutions global leaders in these markets. Although overall issuance remained resilient during the crisis, covered bond markets in the EU remain largely fragmented along national lines and performance varied greatly between Member States. Today's consultation, running until 6 January 2016, will look at the ways to develop an integrated 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.

5. Cumulative impact of financial legislation

The Commission is today launching a 'call for evidence' to gather feedback from consumers, Member States, the financial industry and all interested parties to gauge the cumulative impact and interaction of current financial rules. With this consultation, the Commission hopes to identify inconsistencies, incoherence and gaps in financial rules, as well as unnecessary regulatory burdens and factors negatively affecting long-term investment and growth. Also see Memo/15/5735.

What is the link between CMU and the Investment Plan?

CMU supports and complements the Investment Plan for Europe. Some of the measures, such as promoting infrastructure investment by insurers through Solvency II, a package of measures to promote venture capital and lowering barriers through the prospectus directive will reinforce the Investment Plan.

How did the CMU Green Paper feed into the Action Plan?

There was a large and positive response to the consultations on building a Capital Markets Union, and to the separate ones on the prospectus regime and the proposed EU framework on simple, transparent and standardised securitisation.

The Commission received over 700 responses from businesses, regulators, investors, supervisory bodies, governments, banks, funds, insurers and European citizens.

Feedback has been overall supportive of the importance of building a CMU as well as for the pragmatic, step-by-step approach proposed by the Commission in the Green Paper. The consultation responses also confirmed that the issues identified in the Green Paper were the right ones. The European Parliament and the Council have also expressed support for the Capital Markets Union.

What was the main feedback to the Green Paper?

The number one priority identified by respondents to the consultation on CMU is how to fix Europe's 'funding escalator'. How can we build a financial system that is better able to meet the financing needs of all our businesses — from the smallest micro-firm to the largest listed companies — at the different stages in their development?

The second priority is creating opportunities for investors. Retail and institutional investors – such as pension funds and insurance companies – are the fuel in the tank of CMU. EU capital markets need to deliver attractive returns and good performance for these investors.

Third, the consultation highlighted some long-standing barriers to cross-border investment, which range from tax, insolvency, through collateral management and securities law to post-trade market infrastructure that prevent a better allocation of capital across borders.

Did the feedback vary from one country to the next?

Access to finance continues to be perceived as a major constraint on business development and a drag on growth across all our Member States. A recent study by Ernst and Young[1] reveals that - with the exception of the UK which scores strongly- the largest EU Member States are among the worst performers in the G20 in terms of access to finance. CMU is perceived as a key part of the solution, particularly in those Member States where the banking system is still under repair.

Who will benefit from a well-regulated and integrated Capital Markets Union?

An integrated and well-regulated CMU should support investment in the EU by unlocking financing for Europe's businesses, including SMEs and start-ups.

CMU aims to offer investors and savers additional investment opportunities. Households (retail investors) and institutional investors (insurance companies, pension funds and investment funds) should benefit from a greater choice of investments, including cross-border, accessible at lower costs, with effective investor protection.

Financial institutions, investment firms and financial intermediaries should benefit from more competitive, regulated and integrated EU capital markets with greater scale and depth.

Ultimately, as the CMU develops, EU citizens should also benefit from the expected boost to growth and job creation.

How will individual investors and citizens benefit from the CMU?

The CMU aims to boost investor confidence and offer investors and savers additional opportunities to save for the long term. Retail investors will only invest in capital markets if they trust them and the financial intermediaries operating in them, and believe they can safely secure a better return on their savings.

Retail investors should benefit from a greater choice of investments, greater potential returns, greater risk diversification and lower costs. The CMU should contribute to restoring trust in capital markets, and encourage and enable European households to save more effectively for their retirement.

Key actions targeting retail investors include:

- Looking into the possibilities of developing a policy framework to establish a successful European market for simple and competitive personal pensions to complement existing national solutions to save for retirement and determine whether EU legislation is required to underpin this market; and
- Exploring, through a consultation to be launched by the end of 2015 on retail financial services and insurance views on how to increase competition and cross-border supply of and access to retail financial products; and
- A comprehensive assessment of European markets for retail investment products, including distribution channels and investment advice to identify ways to improve intermediation channels so

that retail investors can access suitable products on cost-effective and fair terms. The assessment will also examine how rules should evolve to benefit from the new possibilities offered by online based services.

How will start-ups benefit from CMU?

Innovation and entrepreneurial spirit are key to unlocking Europe's growth potential. Crowdfunding is developing but remains local. Investment by business angels remains small (just € 357 million in 2013) and concentrated in a handful of Member States.Business angels are individual investors, often experienced entrepreneurs or business people, who invest their own money predominantly in seed or start-up companies and usually provide strategic support to the entrepreneurs of the companies in which they invest.

Start-ups with high growth potential but limited working capital may encounter funding gaps at critical moments in their expansion. Venture capital, which typically provides long-term equity finance, has a key role to play in nurturing corporate success. In the EU, venture capital represents only 1 % of outstanding SME financing as compared to over 8 % in the US.

Key actions targeting start-ups and expanding companies include:

- launching a comprehensive package of measures to support venture capital and risk financing, including catalysing private investment using EU resources through a pan European funds-of-funds, a review of the European Venture Capital Fund legislation and the promotion of best practice on tax incentives; and
- promoting innovative forms of business financing such as crowdfunding, private placement, and loan-originating funds whilst safeguarding investor protection and financial stability.

How will small companies benefit from CMU?

Many European SMEs are struggling to get funding, particularly in those countries worst hit by the crisis. In the euro area, 35 % of SMEs did not get the complete financing they asked their banks for in 2013.[2]A CMU should help small companies gain improved access to greater finance at reasonable costs by alleviating information inefficiencies. It should also help businesses to tap into more diverse sources of funding from investors in the EU and all over the world.

Key actions specifically targeting small companies include:

- modernising 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;
- developing Europe's capacity to link capital-hungry firms with potential investors, including through the possible development of a Europe-wide information system that helps interaction of finance-seeking SMEs and finance providers to find each other throughlinking up national systems, and working with European banking federations and business organisations to structure the feedback given by banks declining SME credit applications;
- promoting advisory capacity in all Member States to assist SMEs that could benefit from alternative sources of finance;
- developing a strategy for providing assistance, where requested by Member States with smaller capital markets, to boost local capital markets' capacity, for example by helping a Member State to grow a local venture capital market;
- working closely with the first SME Growth Markets – a new market sub-category created under MiFID II which would apply from January 2017 and which aims to facilitate access to capital for SMEs - to ensure that the regulatory environment for these incubator markets delivers the expected results;

How will medium-sized and large companies benefit from CMU?

CMU will support investors choosing to place larger amounts into capital market instruments. This should create more choice in terms of funding sources for all businesses, including large corporates. Deeper and more integrated capital markets will also mean enhanced competition and therefore lower costs for business financing.

Key actions targeting medium-sized and larger companies include:

- promoting private placements (i.e. the selling of securities to a limited number of investors), whereby companies issue debt instruments to institutional or other experienced investors, across the EU, building on successful experiences such as the one in Germany and through supporting market-led initiatives such as the one undertaken by the International Capital Market Association (ICMA) to promote the use of standardised documentation;
- a review of the Prospectus Directive to reduce the cost and simplify the process of issuing a

prospectus (see below);

- a review of 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;
- exploring 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; and
- addressing the debt/equity bias through work on the Common Consolidated Corporate Tax Base (see IP/15/5188).

Why is the Prospectus Directive being reviewed?

Prospectuses are legal documents that must be used by companies if they want to issue securities or be admitted on a regulated market. The Prospectus Directiveprovides for an EU-wide regime for prospectuses so that there is an equivalent level of investor protection across the EU and to make it possible for investors across the EU to compare investment options.

But prospectuses are also costly and administratively burdensome for companies to produce, often requiring hundreds of pages of detailed information. And for investors, it can be complex to wade through excessively detailed information.

Experience has shown that certain requirements may constitute unnecessary administrative burdens on companies that draw up a prospectus (especially SMEs), despite efforts to establish proportionate disclosure regimes when the Prospectus Directive was reviewed in 2010. The amount of administrative, human and financial resources needed to draw up prospectuses make it very difficult for SMEs and start-ups to put together the large package necessary to attract the investment they need to grow.

Given the need to enhance access to financing on capital markets for companies (in particular SMEs) at a time of bank deleveraging, a review of this directive is important.

The review will look at when a prospectus is required, and look at ways to streamline the approval process and simplify the information included in prospectuses.

What are the next steps regarding the review of the Prospectus Directive?

The Commission will make a proposal to modernise the Directive by the end of the year.

How will banks benefit from the CMU?

In their role as intermediaries between investors and businesses, banks should benefit from better functioning markets and a deeper integration of the single market for capital as this will mean fewer barriers to cross-border investments and an increase in the number and the volume of transactions, both domestically and across the EU.

Key actions targeting bank lending include:

- Establishing a framework for simple, transparent and standardised securitisation, together with new prudential calibrations for banks in the CRR to help banks to transfer risk safely off their balance sheets to other, longer term investors. (see Memo/15/5733)
- Consulting on the establishment 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; and
- Exploring the possibility for all Member States to authorise credit unions operating outside the scope of capital requirements rules for banks.

How will the CMU support the financing of infrastructure projects?

The European Investment Bank (EIB) estimates that the total cumulative infrastructure investment needs in the EU could reach up to EUR 2 trillion up to 2020. Good infrastructure is a key factor supporting sustainable growth. The energy sector needs to upgrade its networks with the latest technologies, integrate renewable sources of energy and diversify sources of supply. The transport sector must modernise its infrastructure, reduce congestion and improve trade links. The environment needs better waste, recycling and water treatment facilities. Europe needs far-reaching and faster broadband and smarter data centres.

Prudential regulation affects the appetite of institutional investors to invest in specific assets through the level of capital charges required. The CMU should help attract additional private capital from institutional investors to finance the realisation of key infrastructure projects through a review of the prudential requirements in Solvency II for insurance companies that invest in infrastructure projects. Such a review should subject insurers that invest in infrastructure projects to a regulatory treatment which better reflects the true risk of infrastructure investments, whether the investment is performed directly by the insurer or through a European Long Term Investment Fund (ELTIF) vehicle.

The Commission will also complete the review of the impact of the Capital Requirements Regulation (CRR) and of the Capital Requirements Directive (CRD IV) on bank lending to the economy and make changes to the treatment of infrastructure in the CRR, if appropriate. That consultation, which was launched in June 2015, includes a review of the impact of the new rules on capital requirements on the availability of financing for infrastructure and other investments that support long-term growth.

How will institutional investors such as insurance companies, pension funds and investment funds benefit from the CMU?

Institutional investors are important to capital markets as they have a natural capacity to invest over long periods of time. This capacity is under-used at present, as reflected in their low exposure to equities. EU insurance companies and pension funds hold respectively some €8.5 billion and €3.5 billion worth of assets. CMU should offer opportunities to institutional investors to take additional exposure to corporate equity and debt, with a view to better matching assets and liabilities.

Key actions targeted to support institutional investors include:

- gathering evidence on the main barriers to the cross-border distribution of investment funds, including 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;
- assessing the case for a policy framework to establish a successful European market for simple and competitive personal pension product to allow institutional investors (insurers, asset managers and pension funds) to increase their fund-raising; and
- assessing, following consultation feedback which highlighted that the prudential treatment of private equity and privately placed debt in Solvency II constitute impediments to investing in these asset classes, whether changes are warranted. Possible amendments could be brought forward in the context of the 2017 Solvency II review.

How will the CMU help countries with developing/smaller capital markets?

For Member States with developing capital markets, CMU should provide:

- a wider range of finance opportunities to companies with high-growth potential and strong commercial prospects, regardless of where they are located. Entrepreneurs whose companies have strong commercial prospects should benefit, for example, from more business angel investment, venture capital funds, and loan originating funds;
- increased capacity to attract investment through the removal of barriers which prevent a better allocation of capital across borders (reduction in tax deterrents, more efficient insolvency procedures, and more efficient clearing and settlement processes); and
- greater choice and higher potential returns for investors throughefforts to enhance the range of retail investment products on offer, and increased efficiency and service quality in the intermediation chain; and
- a possibility to benefit from tailored assistance from the Commission to develop local capital markets capacity building on the features of the national market.

CMU is about connecting growing and innovative companies with sources of finance - no matter where they are located.

How will the CMU help cross-border investment?

Key actions that aim to facilitate cross-border investment include:

- removing the remaining barriers in the post-trade environment (clearing and settlement);
- enhancing the efficiency of national insolvency regimes and the ability of investors to assess risks related to cross-border investments. For this purpose the Commission will propose, by the end of 2016, legislation on business insolvency and early restructuring, building on the experience with the Recommendation issued by the Commission in 2014 on a new approach to business failure and insolvency;
- increasing legal certainty on the effects of assignment of claims on third parties (where the original creditor transfers the claim to someone else); and
- improving the quality of supervision through convergence of supervisory outcomes.

Will the development of non-bank finance create new risks to financial stability?

By promoting more diverse funding channels and reducing Europe’s dependency on banks, CMU should increase the resilience of the financial system. Nevertheless we need to be alert to financial stability risks that may emerge as a result of efforts to further develop Europe's capital markets. Recent reforms, such as the European Market Infrastructure Regulation (EMIR), the Alternative Investment Funds Managers Directive (AIFMD), the Markets in Financial Instruments Directive (MIFID) and the Securities Financing Transactions Regulation (SFTR) have put in place a range of reforms to make capital markets more transparent, well regulated and robust. The European Securities and Markets Authority will continue to play an important role in ensuring consistent implementation and application of these laws.

As markets develop it will be important to ensure that risks are monitored and mitigated. Work is under way within the EU and internationally to better understand and monitor systemic risks. The Commission will propose changes to the macro-prudential framework in the context of the review of the ESRB in mid-2016 if it appears necessary to allow for effective intervention to contain and mitigate risks arising from market-based finance.

For more details:

MEMO on securitisation

http://europa.eu/rapid/press-release_MEMO-15-5733_en.htm

MEMO on Solvency II Delegated Regulation

http://europa.eu/rapid/press-release_MEMO-15-5734_en.htm

MEMO on cumulative impact of financial services legislation

http://europa.eu/rapid/press-release_MEMO-15-5735_en.htm

[1] http://www.ey.com/Publication/vwLUAssets/EY_G20_-_Funding_the_future:/$FILE/EY-g20-Funding-the-future.pdf

[2] Survey on the Access to Finance of Enterprises (SAFE) 2014.

MEMO/15/5732

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