EUROPEAN CENTRAL BANK
EUROSYSTEM

Building a Capital Markets Union – Eurosystem contribution to the European Commission's Green Paper

General remarks

The European Commission's initiative to establish the main elements of a Capital Markets Union (CMU) within the current legislature is welcome. The CMU project, if well designed and thoroughly implemented, could bring significant benefits to the EU. In general, CMU should aim to enable EU economic actors to access the best-suited financing options possible, while safeguarding financial stability.[1] CMU has the potential to complement the Banking Union, strengthen Economic and Monetary Union (EMU) and deepen the Single Market. It could support the smooth and homogenous transmission of monetary policy and help foster financial stability, inter alia by supporting more cross-border risk-sharing, creating deeper and more liquid markets, and increasing the resilience of the financial system by developing alternative sources of funding to the economy. Not least, the CMU agenda can be used to develop financing tools addressing the specific needs of small and medium-sized enterprises (SMEs), infrastructure projects and long-term financing. CMU therefore also entails a strong potential to support growth and competitiveness in the long run.

Effective implementation of the Green Paper requires a clear prioritisation of actions and a timetable with specific milestones and targets. While the general objectives outlined in the Commission's Green Paper seem appropriate, and the priorities for early action and the measures for the medium to long-term are welcome, the effectiveness of the CMU project will depend on the level of ambition with which it is pursued. The upcoming Commission proposal for an action plan should be built on a strong vision of a genuine CMU and should lay down a clear roadmap on how to achieve this. While quick wins and short-term priorities are important in order to gather momentum, the necessary high level of ambition should be maintained to achieve the long-term objective of CMU. Initiatives which are at a more advanced stage of their implementation should be given priority with a view to ensuring their completion in the short term, as should measures to support alternative ways of financing the economy. This should not, however, preclude early action in areas which are key for the functioning of capital markets (such as addressing problems in national insolvency laws or harmonising key elements of insolvency law, corporate law and taxation of financial products), notably given the political challenge linked to these reforms.

[1] This definition was put forward in the Bruegel paper entitled "Capital Markets Union: a vision for the long term" presented at the informal Economic and Financial Affairs Council (ECOFIN) meeting in Riga on 25 April 2015.

CMU should aim for a high level of financial integration that sustainably completes the Single Market in this area. The financial crisis revealed that integration in European financial markets in the last decade had been partly driven by debt-based wholesale banking flows, which turned out to be prone to sudden reversals in the face of shocks. Therefore, CMU should go beyond (price) convergence in financial markets, which does not in itself guarantee deep and resilient financial integration. Full integration is achieved if all market participants with the same relevant characteristics (i) face a single set of rules when they decide to deal with financial instruments and/or services, (ii) have equal access to a set of financial instruments and/or services, and (iii) are treated equally when they are active in the market. In a genuine Single Market, capital should be allowed to flow freely and should be allocated efficiently without cross-border barriers or frictions linked to the location of resources or actors. CMU therefore needs to be underpinned by the appropriate legal and regulatory framework, as well as market standards that provide a level-playing field and allow markets to integrate further.

CMU should also seek to create the conditions for the development of capital markets. The development of financial markets is linked to (i) markets' efficiency, i.e. the condition in which the resources available in a financial system are allocated to the most valuable investment opportunities at the lowest possible costs; and (ii) markets' size, i.e. their critical mass, comprised of a diversity of available instruments, a large enough investor base and a broad range of investment opportunities, rendering economies of scale possible. In an efficient financial system, markets are competitive, information is accessible and widely distributed, and agency conflicts are resolved through credible contracts enforced by legal systems. In contrast, market failures lead to inefficiency and a lack of efficiency usually impairs the contribution of finance to growth. In particular, start-ups and other small innovative firms are an important source of employment growth and added economic value but face great challenges for their funding. Removing barriers that hamper the development of private equity and venture capital markets would help in overcoming these difficulties and should be an important objective of CMU.

Financial integration and financial development are distinct but interrelated objectives of CMU. While targeting different objectives may require different tools at times, financial integration and financial development are in fact mutually reinforcing factors in improving the performance of a financial system in terms of financing the economy. Integration of markets across borders, for example, fosters development by enhancing competitive pressures, while contributing to integration, as the development of new financial instruments may incentivise cross-border investment and facilitate the sharing of risks. Moreover, the removal of barriers to investment and improvements to the business and investment environment imply a close interaction of the CMU agenda with the third pillar of the Commission's investment plan.

CMU, if well designed and implemented, can contribute to the stability of the financial system and enhance risk sharing. Financial stability refers to a condition in which the financial system – comprising financial intermediaries, markets and market infrastructures – is capable of withstanding shocks and the unravelling of

financial imbalances. This, in turn, mitigates the likelihood of disruptions in the financial intermediation process which are severe enough to significantly impair the allocation of savings to profitable investment opportunities. More cross-border holding of financial instruments could enhance risk sharing across the EU, provided risks are widely spread and held by those investors that are best suited to manage them.

Fostering European equity markets should be a main objective of the CMU. Leading the financial system to rely more on equity rather than debt financing could contribute to financial stability and economic growth by providing loss-absorbing buffers for financial and non-financial firms. Cross-border equity holdings would contribute to the stabilisation of growth in the EU by allowing better risk sharing among Member States. An important impediment to the development of equity financing is the bias in taxation observed in many Member States; initiatives in taxation should therefore aim to reduce the preferential treatment of debt financing as opposed to equity financing while acknowledging that taxation is largely a national prerogative.

As the CMU agenda progresses, sufficient attention should be devoted to potential new risks to financial stability. As mentioned above, while deeper cross-border markets with increased risk sharing across the EU are likely to contribute to enhanced financial stability, increased financial integration can also exacerbate the size and speed of contagion. Moreover, the “push” towards market-based financing may lead to systemic risks building up in parts of the financial system which are typically less regulated and more opaque, such as shadow banking. Therefore, the development of capital markets could imply new sources of idiosyncratic and systemic risks. This calls for stepping up oversight and supervision, potentially casting the regulatory net wider and expanding the tools to allow authorities to address the build-up of risks in market-based activities. These issues are further addressed below.

Transparency and data availability are essential for close surveillance in the context of safeguarding financial stability and reinforcing financial integration. Policy objectives under the CMU agenda should be measurable and supported by a wide range of statistics, indicators and standardised data, potentially reusing or enhancing the already strong statistical toolset available within the E(S)CB. Furthermore, adequate priority should be given to actual market transparency, in particular supported by (i) compulsory standard universal identifiers, (ii) a robust data infrastructure for granular information, and (iii) access to relevant information by all stakeholders.

A single rulebook is needed to enhance the level playing field and support the integration of capital markets in Europe. In some areas, market-led initiatives should be supported to ensure that market participants’ needs are taken into account. These may, however, be insufficient and need to be complemented by legislative action, for instance in the presence of information asymmetries or incentive problems. In addition, the legal and regulatory framework is an important enabler for market initiatives to flourish. A genuine single rulebook for capital markets is needed to ensure pan-European regulatory consistency and a level playing field.

To that end, further progress could be made, inter alia, on making use of regulations instead of directives as far as possible, and reducing national discretions and gold plating, in particular identifying and removing those that create costs and frictions for the cross-border flow of capital.

Legislative action in targeted areas is warranted. The broader legal framework for the development of capital markets will need to tackle barriers in areas which are indirectly related to capital markets, such as insolvency law or taxation. In these areas, the Commission could conduct further analysis to identify areas where harmonisation would be most beneficial for the development and integration of capital markets. In politically challenging areas, individual elements of law could be harmonised, for example by amending existing legislation, or through the development of an EU "29th regime", complementing the national frameworks. Further harmonisation at EU level could then be developed over time. In addition, determined and concerted action at the national level to lower cross-border barriers would be important as a first step.

Further reducing existing fragmentation in financial market infrastructures will be a key dimension in establishing CMU. The focus should be on greater harmonisation of rules concerning securities, collateral, message and data standardisation. It would help to remove the remaining barriers preventing cross-border access and ensure level playing field conditions for investors and issuers of financial instruments in the EU. The T2S project aims to create a single platform for securities settlement in Europe. It will facilitate post-trading integration by offering core, neutral and borderless pan-European securities settlement in central bank money so that central securities depositories (CSDs) can provide their customers with harmonised and commoditised delivery-versus-payment settlement services in an integrated technical environment (covering both domestic and cross-border business). This initiative will thus provide a substantial improvement in securities settlement. However, while TARGET2-Securities (T2S) will reduce certain barriers, its potential can only be fully explored if the remaining barriers (including those identified by the Giovannini Report[2]) in the field of market infrastructures are addressed. At the same time, the safety and efficiency of financial market infrastructures throughout the EU have to be preserved. Measures to enhance competition and facilitate competitiveness should be coupled with steps to ensure their safety and robustness.

CMU warrants a strengthened implementation and enforcement of rules, and an appropriate supervisory framework leading ultimately to a single European capital markets supervisor. As a first step, supervisory convergence should be enhanced with a view to delivering a common implementation and enforcement of rules. The powers of the European Supervisory Authorities (ESAs) in this respect should be enhanced in order to ensure supervisory harmonisation and the early identification of a build-up of risks. As the European financial structure evolves over time, the steady state of the supervisory framework should be assessed and improved to match the needs arising from the development of CMU. The case for

[2] For more information on the barriers identified by the Giovannini group, please see the ECB website (Link)

integrated supervision at the European level is strong for those segments of the capital market where integration is very advanced and the emergence of cross-border risks is likely. It is particularly important for pan-European entities and activities to ensure equal enforcement across the EU. Ultimately, the roadmap towards a genuine CMU underpinned by a high level of financial integration and a single rulebook should thus include a single capital markets supervisor as a final destination. At the same time, national competent authorities will continue to play a key role given their expertise in assessing the risks emerging from specificities in the local capital markets and proximity to local economic actors (such as SMEs).

CMU is first and foremost an EU-28 agenda, but enhanced cooperation in some relevant areas could be explored. CMU is an agenda for the completion of the single market based on a single rulebook which should seek to limit fragmentation. However, in some cases where no political agreement can be found for progress at EU level, the potential for a "vanguard group" of countries to proceed on the basis of enhanced cooperation could also be explored while avoiding introducing new fragmentation. A differentiated level of integration could be justified for the euro area without undermining the Single Market (as is the case with the Single Supervisory Mechanism (SSM), which remains open to Member States which are not part of the euro area). Well-functioning cross-border capital markets which facilitate risk sharing and capital flows across sectors and countries are especially relevant in a monetary union with strict budgetary rules and high debt levels, and with conventional monetary policy unable to address asymmetric shocks. In addition, well-developed and integrated capital markets are important for the transmission of monetary policy. Euro area countries could therefore have a particular interest in quick progress on CMU.

As CMU is pursued, a broader and strengthened macroprudential toolkit is warranted. To reap the benefits from financial integration without raising concerns for financial stability requires enhanced risk surveillance and a broader and strengthened macroprudential toolkit. Better data collection, which currently tends to be fragmented across different systems, increased coordination among macroprudential authorities (for example through the European Systemic Risk Board (ESRB)) and an enhanced toolkit to deal with the build-up of risks in market-based activities and entities outside the regulated banking sector should form part of the CMU agenda. In this regard, macroprudential tools tailored to addressing such risks should be provided for in the regulation and added to the macroprudential toolkit available to competent authorities. Moreover, the ability to cast the regulatory net wider and capture systemically important non-banks which are within the regulatory perimeter and subject to enhanced supervision and regulatory requirements should be made possible.

Even if a genuine CMU is achieved, banks will continue to play a central role. CMU should aim towards a structural change in the European financial architecture. Europe's dependence on bank lending proved to be a drag on the recovery due to the necessary (and still ongoing) deleveraging of banks and the private sector induced by the crisis. However, market funding should complement, not replace, the role of banks in financing the economy. In particular, banks will continue to play a

critical role as financial advisors for borrowers, especially for SMEs, and as gatherers of credit information and investment opportunities for institutional and retail investors. Ensuring a healthy and robust banking system that is able to provide credit and support economic growth will therefore remain key, despite the envisaged diversification of funding sources through CMU. In addition, banks will continue to play a critical role in capital markets as issuers, investors and intermediaries. They are vital in the design of CMU and they can also support the development of other forms of funding. In this context, the establishment of the SSM is expected to support the role that banks can take on in the context of CMU. By ensuring a safe and sound banking system and by eradicating ring-fencing or more protectionist practices related to national champions, the SSM will also contribute towards supporting the provision of cross-border financial services.

The ECB will also play a role in this project. First, the ECB stands ready to work closely with the Commission to provide technical expertise on the various areas of CMU. Second, the ECB plays a role as catalyst vis-à-vis the markets, notably through the joint initiative with the Bank of England (BoE) on the revival of high-quality securitisation, and as a monetary policy institution more generally. Finally, the Eurosystem plays a role as an operator in the markets. The T2S initiative will greatly facilitate cross-border bonds and equities trading, thereby also contributing to the objectives of CMU.

The next sections provide more details on the specific sections of the Green Paper, namely on (i) priorities for early action; (ii) improving access to finance; (iii) developing and diversifying the supply of funding; and (iv) improving market effectiveness, with a focus on the need for a single rulebook, strengthened supervision at EU level, issues related to market infrastructures and specific areas where further legislative work is warranted.

A. **Priorities for early action:** quick wins are important to gather momentum for the CMU project. This does not preclude decisive action being taken in parallel – particularly in politically sensitive areas – to ensure the longer-term success of CMU. **Key priorities** should include (i) revitalising the European securitisation market, (ii) enhancing the availability and standardisation of information (especially of SME credit information), and (iii) further developing private placement (PP) markets.

B. **Ways to improve access to finance:** CMU should tackle the barriers preventing access for both issuers and investors to financial instruments and/or services. **Key actions** could focus on (i) developing a simplified and harmonised accounting framework for SMEs, (ii) further developing covered bonds markets (e.g. through greater standardisation of corporate bond features that contribute towards improving market liquidity), and (iii) developing alternative sources of financing to cater for the specific needs of smaller firms (e.g. further developing alternative investment markets designed for issuance of SME bonds, or peer-to-peer funding).

C. **Ways to develop and diversify the supply of funding:** CMU aims to increase and diversify the sources of funding for investors in the EU and all over the

world by removing regulatory and non-regulatory barriers. **Key actions** will need to be taken with respect to (i) incentives created by taxation (e.g. removing or reducing the debt-equity tax bias), (ii) supporting long-term investment (e.g. removing unjustified barriers that discourage pension funds and insurance companies from investing in infrastructure projects and equity), (iii) abolishing barriers to the distribution of investment funds (e.g. further initiatives to harmonise cross-border shareholder transparency procedures), (iv) fostering the development and integration of private equity and venture capital markets (e.g. promoting initial public offerings (IPOs) and mergers and acquisitions (M&As), (v) supporting trade finance (e.g. through a pan-European scheme for trade finance), and (vi) creating a supportive business environment to stimulate investment.

D. **Intermediaries, infrastructures and the broader legal and supervisory framework:** CMU needs to be supported by key factors for the integration and development of financial markets. This includes a single rulebook, completed by an appropriate enforcement and supervisory framework matching the development of capital markets; a supportive legal framework in important fields such as taxation of financial products, company law – including corporate governance, recovery, resolution and insolvency laws – and securities ownership rules; efficient market infrastructure; and well-functioning cross-border flow of collateral. **Key actions** will need to focus on (i) closing legislative loopholes in the single rulebook, making use of regulations rather than directives, and (ii) limiting national discretions to ensure a level playing field. In addition, legislative work can be undertaken in several specific areas, for instance by (i) introducing a framework for the recovery and resolution of non-bank financial institutions, in particular central counterparties (CCPs), (ii) achieving a more efficient and harmonised insolvency regime for non-financial firms, (iii) reviewing insolvency rules for credit institutions, (iv) harmonising insolvency procedures for participants in securities settlement systems operated by CSDs, and (v) creating a harmonised, streamlined "relief at source" procedure for withholding tax relief. Finally, measures to improve the cross-border flow of collateral could include (i) achieving convergence of collateral ownership rights and safekeeping arrangements in cross-border transactions, (ii) ensuring the legal enforceability of close-out netting arrangements on a cross-border basis, and (iii) improving collateral management arrangements.

A Priorities for early action

The identification of quick wins is important to gather momentum for the CMU project. A clear prioritisation of actions is therefore needed to promote initiatives in those policy areas which are at a more advanced stage of their implementation, which would more immediately enhance the functioning of capital markets, or which are key to enhancing financing to the real economy (especially SMEs and long-term investments). The five areas identified by the Commission as short-term priorities – namely reviewing the Prospectus Directive, improving the availability of credit information about SMEs, building a sustainable, high-quality EU securitisation

market, increasing investment in European long-term investment funds (ELTIFs), and developing private placement (PP) markets – are indeed important in the short term. This does not preclude decisive action being taken in parallel (also in politically sensitive areas) to ensure the long-term success of CMU.

Initiatives aimed at revitalising the European securitisation market by promoting simple, transparent and standardised (STS) securitisation should be given priority. As a financial instrument, securitisation can play a unique role as a funding tool, a risk transfer tool, or both. As a funding tool, securitisation broadens banks' access to a diversified investor base. As a risk transfer tool, securitisation could free up bank capital, allowing banks to extend new credit to the economy in general, and to SMEs in particular, even as they deleverage. There has already been considerable progress at the European and international level regarding the identification of simple and transparent securitisations that could benefit from differentiated regulatory treatment, and the Commission has already taken key steps to differentiate the regulatory treatment of such securitisations for liquidity and insurer capital purposes. The ECB and BoE have played a key role in this initiative to revitalise the European securitisation market by promoting STS securitisation and have provided their views on the key issues on a number of occasions, most recently in a joint response to the Commission's consultation on an EU framework for simple, transparent and standardised securitisation.[3] These developments build on previous ECB initiatives to promote greater transparency in securitisation instruments, in particular in relation to the provision of loan-level data and the motivation of the private market to establish a repository to store this data (the European DataWarehouse). The creation of a pan-European STS securitisation market would be greatly supported by the homogenisation of national legislation in the EU with regard to insolvency laws, insolvency procedures and the legal enforceability of collateral, as discussed in the last section of this document.

Enhancing the availability of SME credit information is key for the functioning of capital markets. A major obstacle to SMEs' access to markets is the lack of information on their credit quality. The 2013 report of the High Level Expert Group on SME and Infrastructure Financing (HLEG Report)[4] identified a number of possible actions in this regard, in particular action to facilitate credit analysis via public and private databases, the aggregation of business registers, standardised and more widespread use of credit scoring, and standardised loan-level information on asset-backed securities (ABS). Transparency can only be achieved through strict standardisation of the basic data and full automation, end-to-end, in the data provision, as well as through an appropriate data sharing framework. Although information can be provided by both public credit registers and private credit bureaus, experience shows that the prerequisites for

[3] "Joint response from the Bank of England and the European Central Bank to the Consultation Document of the European Commission: An EU framework for simple, transparent and standardised securitisation" (Link)

[4] The report can be found at the following address (Link)

transparency can only be achieved by the active role of public institutions and the setting up of legal obligations.

The ESCB is currently finalising work on a granular credit risk dataset (‘AnaCredit’), and a final decision on AnaCredit is expected this summer. The first stage of this ESCB initiative will allow enhancements in the set of tools of policy-makers based on transparent, harmonised and granular information on credit granted by credit institutions to financial and non-financial corporations and general government by early 2018. Later stages could achieve a broadening of the scope and user base of AnaCredit.

Standardising information (unique identifiers for institutions, products and transactions) is needed for a workable and high-quality data infrastructure. In particular, the compulsory use of international identifiers, namely the International Securities Identification Number (ISIN), the Legal Entity Identifier (LEI), a Unique Product Identifier (UPI) and/or a Unique Instrument Identifier (UII), and a Unique Transaction Identifier (UTI) for all securities and derivatives should be established. Furthermore, it should be ensured that a minimum set of standardised information covering the main features of all institutions, products and transactions in financial markets is available to all stakeholders. This goes beyond specific market segments and should be applicable to all financial markets.

Developing private placement (PP) markets will be key for medium-sized and unlisted companies. As PP markets already exist in a number of Member States, lessons can be drawn from their successful implementation for the development of PP markets in other Member States. PP plays an important role for non-financial corporations which cannot access public market financing or traditional lending sources, or can only do so on unfavourable terms. The 2013 HLEG report identified the main barriers for the development of PP markets. These are related to the illiquidity of this instrument, the lack of market visibility of new transactions, the lack of standardisation of loan documentation and covenants, and potential unfavourable tax treatments. The recommendations made in the report deserve appropriate follow-up at the national and European level, and should take into account industry associations’ work in laying the foundations for a pan-EU PP market. In addition, the Commission should identify areas where further standardisation or possibly the setting-up of common framework could support the development of these markets within the Member States and also on a cross-border scale. The Commission’s action should seek to play a catalyst role in laying the foundations of PP markets and look at possible areas for harmonisation across national markets.[5]

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[5] Some areas where EU legislative harmonising measures might be readily deliverable in the short term would be in assisting in harmonising and reinforcing existing core standards/transparency for both loan and note documentation; setting standards to increase comparability of national insolvency laws, tax and accounting regimes; increasing comparability and availability of issuer-relevant information through both data repositories and balanced qualitative obligations relating to due diligence standards and issuer disclosures; setting uniform measures on existing offering, disclosure and transparency standards, as well as extending periodic disclosure obligations to unlisted issuers of PP issuances; promoting harmonisation of the transferability and settlement of

B Improving access to finance

A key objective of CMU is to improve capital markets' effectiveness in allocating resources and match the supply of funding with demand for capital. This entails tackling the barriers preventing access for both issuers and investors to financial instruments and/or services. Harmonisation of information and processes would be a key enabler in this regard, together with increased transparency on applicable legislation and rules for financial products, increased access to information with respect to cross-border investment opportunities, and increased competition in financial product services for the benefit of consumers. The development of a simplified and harmonised accounting framework for SMEs could be a helpful step. In addition, measures to develop alternative sources of financing (such as secured and unsecured bond markets or crowdfunding) can fill a gap in financing small investments.

Developing a simplified and harmonised accounting framework for SMEs could be helpful. The current patchwork of national generally accepted accounting principles (GAAPs) and lack of disclosure needs to be complemented by the creation of a simple common accounting language for SMEs in the EU.[6] Unlike previous initiatives (e.g. "IFRS for SMEs"), the framework must be simple and ensure reduced compliance costs in order not to create a barrier to capital market access, while at the same time it must be credible and comparable. This could be coupled with a standardised template for disclosure. These measures would improve the ability of investors to assess and compare the financial performance of SMEs. By improving transparency and reducing information asymmetries, investors could feel more comfortable in assessing the underlying risk. In this context, the Commission, together with European accounting standard setters, could develop a simple and harmonised framework for SMEs, while guaranteeing that potential investors obtain the required information.

Greater standardisation of certain bond features could improve market liquidity. The debt financing of non-financial corporations in Europe is dominated by bank loans. Further developing corporate bond markets could help diversify the financing of these entities. In this regard, increased standardisation efforts could be helpful and could focus on (i) the terms and conditions included in bond issuances, as this would enable easier due diligence for investors, thus lowering transaction costs and enhancing liquidity; and (ii) some key characteristics of bonds, such as the coupon date and rate. Importantly, the aim is not to stifle innovation or introduce rigid

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PP issuances, as well as measures to strengthen the possible avenues for the listing of PP issuance. Additional work would be welcome to ensure regulatory consistency, and that certain investors are not disproportionately disincentivised by qualitative and/or quantitative restrictions in investing in PP issuances by virtue of existing or forthcoming legislation such as AIFMD/R or Solvency II.

[6] It should be noted that a new Directive 2013/34/EU ("Accounting Directive") was adopted in the EU in June 2013 with the aim of reducing the administrative burden for small companies. Moreover, a global accounting framework for smaller companies already exists: in 2009 the International Accounting Standards Board (IASB) published "IFRS for SMEs", a separate accounting standard intended to apply to the general purpose financial statements of SMEs, private entities and non-publicly accountable entities. However, neither of these initiatives has produced the results expected. With regard to IFRS for SMEs, it is still considered too complex and burdensome for the average SME in the EU.

features that would not allow for needed bespoke flexibility, but rather to promote some further standardisation and in doing so promote deeper, more dynamic markets with fewer individual small bonds outstanding. It would also facilitate the creation of hedging instruments (derivatives) which could support market liquidity. For example, the establishment of a market guide by market participants on common market practices, principles and standardised documentation for PP is welcome. Market-led initiatives could play a role in promoting the standardisation needed for the cross-border functioning of capital markets. However, these could be complemented by legislative action where private initiatives are insufficient or fail to attain their objectives. Such an approach by the Commission could provide a legislative overlay that focuses on achieving deliverable harmonising measures while concurrently promoting comparability of issues where harmonisation is less easy to achieve.

Further harmonisation of the European covered bond market framework is warranted. National covered bond frameworks are still quite heterogeneous across Member States and covered bonds can have many different legal forms and structures depending on the jurisdiction where they are issued.[7] In concrete terms, heterogeneities related to the characteristics of the cover pool (pool composition), but also the valuation of mortgage cover assets, loan-to-value measurement and related limits (LTV limits), as well as coverage principles and required over-collateralisation may deserve further harmonisation. Harmonised regulation should be orientated towards those strict rules that already exist in individual Member States that have proven to provide an attractive framework for private investors. In this context, the Commission's proposal for a European covered bond market framework that is expected to be issued before the end of the year end will be welcome. However, any harmonisation under EU law should not lower the legal standards under national covered bond laws.

Developing alternative sources of financing is needed in order to cater for the specific needs of smaller firms. Alternative investment markets designed for the issuance of SME bonds (for example, the mini-bonds initiative in Italy) are examples of potential initiatives. Exploiting less stringent regulation and tax incentives, these alternative markets aim to overcome the major barriers in terms of costs and transparency requirements that usually prevent SMEs from accessing external finance through bond issuance. Overall, mini-bonds allow for a higher diversification of debt and a consequent mitigation of risks related to a strong dependence on bank financing. Initiatives to enhance the liquidity of such instruments and incentivise investors are needed, such as the mandatory listing on particular segments of regulated markets or multilateral trading facilities (MTFs) with simplified listing requirements and/or the use of some covenants and guarantees. These instruments

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[7] However, for the purposes of a capital requirements assessment of these structures, Directive 2006/48/EC laid down a set of criteria regarding high-quality covered bonds in the EU, which foresaw a preferential treatment of exposures in the form of covered bonds where the cover pool of assets met certain eligibility requirements. The Capital Requirements Regulation (CRR) takes this concept of preferential treatment one step further, as covered bonds may only be subject to the preferential treatment for the purposes of the capital adequacy assessment if certain transparency requirements are met.

can be issued at medium to long-term maturities, allowing a lengthening of the average duration of firms' financing.

Peer-to-peer finance (crowdfunding and peer-to-peer lending) is another example of such alternative financing tools. Despite being a relatively new and small source of entrepreneurial finance, this source of funding is growing rapidly and has the potential to reach many smaller firms in a wide range of industries, for which other market-based sources of finance are inaccessible. Crowdfunding has the potential to provide financing means which are tailor-made to the needs of certain actors, such as small firms or individual entrepreneurs.

A common EU regulatory framework for crowdfunding could support a level playing field in this area. Crowdfunding constitutes a promising initiative to increase retail investors' participation in, and awareness of, credit markets, for the disintermediation of financing of start-ups, and to reduce the cost of credit. The development of a common EU regulatory framework at an early stage could prevent national legislations from creating an uneven playing field. The analysis of crowdfunding practices across Europe suggests that there are still legal and regulatory barriers and uncertainties which constrain its potential, both in terms depth of the market and integration across borders. The responses to the Commission's "Consultation on Crowdfunding in the EU" can serve as a basis to map where these barriers lie and how to better address them. In addition, the Commission could provide centralised information on applicable rules depending on Member State and type of crowdfunding for potential investors, borrowers and platform providers. However, less stringent regulatory standards and transparency requirements should not lead to an excessive build-up of risks in specific market segments or adverse effects on investor protection.

C Developing and diversifying the supply of funding

A further key objective of CMU is to increase and diversify the sources of funding for investors in the EU and all over the world. The size of capital markets ultimately depends on the flow of savings into capital market instruments. Thus, for capital markets to thrive, they need to attract institutional, retail and international investors. Generally, attractiveness for institutional investors is driven by transparency, costs, returns and risks. Accordingly, in order to enhance and diversify the supply of funding, initiatives will need to improve the attractiveness of EU capital markets. Institutional investors' role in channelling funds to the economy is pivotal, but it is often restricted by regulatory and non-regulatory obstacles. A key non-regulatory issue is the need to remove or reduce the tax advantage of debt funding relative to equity, which can distort investment decisions. As regards regulation, measures should be considered to remove unjustified barriers that discourage pension funds and insurance companies from investing in infrastructure projects and equity. In addition, barriers to the cross-border distribution of investment funds should be identified and removed to allow for a more efficient diversification of risk across the EU. Measures to support cross-border participation in Undertakings for Collective Investment in Transferable Securities (UCITS) would be welcome. To attract retail

investors, a good balance between easy, understandable and transparent access to the capital market and consumer protection should be found.

Taxation creates incentives. Initiatives in taxation should aim to reduce the preferential treatment of debt financing as opposed to equity financing. This can facilitate a greater reliance by firms on equity and have a positive impact on their access to other forms of finance. It could also be important to rebalance the financial structure of firms, especially in those countries where the level of indebtedness in the non-financial corporation sector is still significant. Moreover, taxation can be used as a tool to stimulate venture capital funding and innovation. Measures to incentivise equity financing, especially for SMEs, could be considered in the short term through a specific Recommendation from the Commission. One possible option could be the use of an allowance for corporate equity (ACE) in corporate tax income.

Measures can be taken to support longer-term investment. A further revision of the CRR/Solvency II frameworks to lower capital requirements for banks and insurers in infrastructure investment would be helpful in this respect, as long as it is prudentially sound and all risks are captured in lower capital requirements. Other measures, such as the creation of infrastructure subclasses which could entail tailored prudential rules, similar to the securitisation project, can be also supported. For the financing of infrastructures investment, corporate bonds and syndicated and promotional loans would constitute the most likely candidates for a tailored treatment from a regulatory perspective. In this respect, interesting initiatives, such as the pilot phase of the Project Bond Initiative managed by the European Investment Bank, which mixes public and private investment, seem promising and should be explored further. However, in practice it might be difficult to single out precisely within a given asset class those instruments used to fund infrastructure investment. Therefore, these instruments should first be clearly defined and mapped with the existing prudential asset classes before any tailored treatment is considered.

Barriers to the cross-border operation of investment funds should be removed to benefit investors and facilitate a more efficient distribution of risk across the EU. These barriers include the diverging practices in fund shares' issuance and holding procedures across markets and issuers, and non-harmonised rules for the identification of shareholders (including fund shareholders) on a cross-border basis. In addition, with the exception of large cross-border investment fund industries in some countries (i.e. Luxembourg and Ireland), there is still some fragmentation in the UCITS market, with limited cross-border participation and limited cross-border risk sharing. In this model, fund shares are continually issued and redeemed in the primary market, as opposed to the more standardised model for exchange-traded funds (ETFs), which are already trading in EU secondary markets. Therefore, action should be taken to simplify trading in the secondary market. Funds industry associations and stakeholders should be in the lead when it comes to harmonising and simplifying procedures for the issuance and cross-border distribution of investment fund shares. However, progress in harmonising rules and practices for the disclosure of cross-border shareholder information may require legislative and/or regulatory harmonisation at EU level. The Commission proposal for amending the Shareholder Rights Directive (COM/2014/213) seems to go in the right direction. It

proposes that the request of the issuer to identify who their shareholders are is enforceable independently of the intermediation chain.

Creating incentives for investors and removing non-regulatory barriers will help the development and integration of private equity and venture capital markets. Initiatives for the creation of stock exchanges aimed at listing smaller, and in particular high tech and/or innovative companies[8], will be conducive to the development of private equity (PE) and venture capital (VC) markets. Banks are often more reluctant to lend to these companies and stimulate the growth of industries that rely on intangible assets and limited tangible collateral. PE companies (at later stages of the firm's life) and VC funds (at early stages of the life of young innovative companies) solve this problem through a combination of three distinct activities: careful screening and selection of the best projects, sophisticated contracting and structuring of the investment, and adding value by monitoring and aiding companies in which they invest. In addition to being successful at the micro level, their investments can have positive aggregate implications in terms of innovation and new business creation. A number of factors can contribute to the emergence of a dynamic and successful PE and VC industry. It should be acknowledged that PE and VC funding will remain a niche market overall. At the same time, this type of funding may be particularly valuable for high risk and growth enterprises, as well as for innovative firms which may not have access to other sources of funding. Alternative investment markets (AIM) designed for the issuance of SME bonds have been established recently and are still less developed compared to analogous platforms targeting the issuance of SME equity. Exploiting less stringent regulation and tax incentives, these alternative markets aim to overcome the major barriers in terms of cost and transparency requirements that usually prevent SMEs from accessing external finance through bond issuance. A thorough assessment of these markets and the potential elements for providing new impetus could serve to enhance their potential.

Start-up companies, namely those funded by VC, should be able to become public through IPOs and M&As. The economic rationale for publicly listing VC-funded companies is that the existence of viable exit markets for venture investments increases the expected return for investors and entrepreneurs. Despite setbacks during the burst of the dot-com bubble, the existence of "new" stock markets for high tech firms remains of primary importance for the success of the VC and PE model, more so than the amount of VC funding itself, because it strongly affects the composition of portfolio companies that receive VC funding. At the same time, these types of alternative funding sources can be expected to remain limited, but may be relevant for small and innovative start-ups.

Creating a supportive business environment by strengthening the ease of doing business is key for promoting investment. This could be targeted by removing barriers to entrepreneurship, such as entry and general administrative costs, as well as other types of rigidities. Lifting such restrictions can lower the

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[8] Even though some gains in depth can be achieved by merging already existing stock exchanges. For example, there are 16 stock exchanges in the United States and 49 in the EU.

regulatory costs of entrepreneurial activity and result in a higher rate of new business creation of innovative companies. The Commission could attach greater importance to fostering research and development and create a supportive business environment under the European Semester.

A pan-European scheme for a better functioning and more efficient trade finance market should be facilitated to overcome current market segmentation and enhance access to trade finance. Trade and receivables financing represent an important alternative source of direct finance for SMEs, particularly in recessionary periods. Therefore, factoring and trade bill markets can play a vital role in complementing bank finance for this sector. Today, trade finance is characterised by segmented national markets and largely paper-based procedures in the EU. A better functioning and much more efficient trade financing market could be built on the grounds laid down by the Single Euro Payments Area (SEPA) scheme (adopted and adhered to by almost 7000 banks in Europe), in particular when the emerging initiatives to create pan-European scheme(s) for SEPA-based e-invoicing are taken into consideration. In an open and standardised e-invoicing scheme, the acceptance of invoices by debtors as valid claims on themselves could happen in real time; all necessary information could be immediately available to potential bank or non-bank financing parties[9] anywhere in Europe. Furthermore, such a standardised electronic scheme could greatly facilitate the securitisation of trade receivables, providing even better financing conditions for SMEs. The Commission's report on achieving greater legal certainty in cases of cross-border transfers of claims for factoring and other means of financing should provide a deeper analysis of the potential barriers to building such a pan-European scheme.

D Improving market effectiveness – intermediaries, infrastructures and the broader legal and supervisory framework

In general, key factors for the integration and development of financial markets are (i) the legal system and financial regulation, (ii) the efficiency of market infrastructures (payment, clearing, settlement and trading systems), and (iii) other conditioning features (e.g. social norms, basic freedoms and political systems). This section looks in more detail at the first two elements – in other words, the need for a single rulebook, appropriate supervision and rules enforcement in capital markets – and a number of necessary (legislative) measures for the good functioning of capital markets from a central banking perspective.

1 Single rulebook, enforcement and supervision

Full financial integration means ensuring that all actors are subject to the same set of rules, are treated equally and have equal access to the markets. This implies the

[9] Other parties are factoring companies and other third-party buyers of trade receivables.

creation of a genuine European single rulebook complemented by strengthened supervisory convergence delivering uniform implementation. A single set of rules would also require tackling conflicting national laws, ensuring that stakeholders receive the same degree of protection throughout the market, and providing for a more harmonised taxation of financial products. In the long term, the success of CMU will need to entail enhancements to the supervisory framework of capital markets, such as the direct supervision of certain market segments, commensurate with the development of capital markets and the possible emergence of risks. This process could start with an assessment of the sectors and products for which supervision at EU level may be most appropriate. Ultimately, the roadmap towards a genuine CMU underpinned by a high level of financial integration and a single rulebook should include a single capital markets supervisor.

1.1 Single rulebook

Pan-European regulatory consistency in the form of a single rulebook is needed for the integration of capital markets. Market-led initiatives to promote capital markets are important but would be insufficient if they are not accompanied by the appropriate high-quality legal, regulatory and supervisory framework that acts as an enabler for market initiatives to flourish. In order to give capital markets sufficient scope and depth for both issuers and investors, there is a need for a genuine single rulebook providing a harmonised regulatory framework for capital markets. To that end, rules will need to be strengthened and complemented by adapting existing legislative measures or taking further legislative measures.

One step will be to close existing gaps by issuing missing regulation. While EU legislators have introduced much new or revised legislation intended to harmonise the regulatory framework for capital markets in recent years (e.g. the Markets in Financial Instruments Directive II (MiFID II)/Markets in Financial Instruments Regulation (MiFIR), European Market Infrastructure Regulation (EMIR), UCITS, Alternative Investment Fund Managers Directive (AIFMD) and Market Abuse Regulation (MAR)), several areas of this legislation could be subject to further harmonisation. Possible measures to promote the flow of collateral throughout the EU and improve the legal enforceability of collateral and close-out netting arrangements on a cross-border basis should also be explored. Not least, it is essential that Solvency II for insurers, the Institutions for Occupational Retirement Provision (IORP) Directive proposal for pension funds and the Capital Requirements Directive IV (CRD IV) for banks make a proper assessment of the capital requirements for investing in long-term projects, private equity and venture capital.

The use of EU regulations should be the norm and directives the exception. As part of the drive to create a single rulebook, regulations which are directly applicable should be used instead of directives to preserve the level playing field in the EU and ensure a more efficient allocation of funding sources across institutions.

Limiting national discretions and "gold plating" will be key to ensuring a level playing field. A significant number of provisions in existing regulations still allow for

national supervisory and/or regulatory options, and national discretions. This contributes to maintaining market fragmentation along national lines and hindering comparability on an EU-wide basis, which can also cause a competitive disadvantage for institutions established in some Member States. From a practical perspective, the Commission could consider developing further technical tools to facilitate the use of a single set of rules, for example in the form of a consolidated online resource for the single rulebook, with a view to promoting its harmonised implementation across Member States.

An adequate regulatory and legal framework would also imply more steps towards greater harmonisation of insolvency law, company law and taxation of financial products despite the inherent political challenges. While bold action towards the completion of the single rulebook for capital markets will be desirable, a gradual approach to harmonisation could be envisaged in those specific areas where political sensitivities prevent action at EU level in the short term, in order to achieve an effective CMU. In this regard, individual elements of law could be harmonised, for example by amending existing legislation, or through the development of an EU “29th regime” in some areas[10], complementing the national frameworks. Further harmonisation at EU level could then be developed over time. In this context it is worth noting that with regard to the treatment of bonds, differences depending on the legal jurisdiction of the issuer will remain, in particular with regard to investors’ uncertainty as to how certain events will be dealt with in different jurisdictions. Thus, there should be further exploration into whether it is possible to have a fully harmonised CMU legal framework without all bonds being issued in one country under the same legal framework. See also Section 4.3 below.

1.2 Supervisory convergence and enforcement

In the short term, the powers of the ESAs[11], including of ESMA, could be further enhanced to ensure a common implementation and enforcement of the single rulebook for capital markets throughout the EU. The single rulebook for EU capital markets needs to be complemented by strengthened implementation and enforcement of rules. National discretion in the application of standards set at EU level and varying degrees of supervisory scrutiny may lead to regulatory arbitrage and to an increased concentration of securities market participants in a few jurisdictions. In addition, differing national supervisory regimes may result in differing investor protection levels, barriers to cross-border operations and discouragement for companies seeking financing in other Member States. In this

[10] The concept of a 29th regime refers to a supranational regime, for example a supranational corporate form or legal instrument, which does not replace existing national laws, but offers an additional option to private parties to choose which of the body of law will govern their legal relations.

[11] Under the current Regulations, the ESAs have existing powers to foster supervisory convergence, in particular by means of technical standards, guidelines, recommendations and binding mediation powers for the purpose of settling disagreements between competent authorities in cross-border situations. Moreover, the use by ESAs of soft law instruments in the form of Q&A documents (a tool which is not foreseen in the Regulations) seeks to assist with the consistent interpretation of technical standards.

context, the crucial role of the ESAs in the convergence of supervisory methods, the peer review of national supervisors, prospectus liability, and in determining the equivalence of rules in third countries should be expanded. For example, the amendment to the EBA Regulation has empowered the EBA with the additional task of establishing a European supervisory handbook on the supervision of financial institutions in the EU as a whole, which sets out supervisory best practices for methodologies and processes. Similarly, this could be foreseen for the other ESAs, and in particular for ESMA, with respect to issues strengthening the capital markets directly. ESAs could also take more initiatives on consumer and investor protection matters, notably with respect to client assets and client money.

In the longer term, the EU supervisory structure should take into account changes in the EU financial structure. The framework of the supervision of securities markets and their participants is still heterogeneous across the EU. Although the establishment of ESMA has been a major step towards a more harmonised framework and towards the fostering of convergence of supervisory practices, the day-to-day supervision of securities market participants is still left largely in the hands of national competent authorities. The long-term goal of deepening and integrating EU capital markets entails a more structural change to the financial architecture of the EU. Lessons from the crisis should be drawn, in particular regarding the interplay between the Single Market and an incomplete regulatory and supervisory framework for banks. Therefore, single supervision of at least specific market segments needs to be envisaged. This is particularly important for pan-European entities and activities in order to ensure equal enforcement across the EU, thus ensuring no leakages by moving activities across borders. EU-level supervision already exists within ESMA for trade repositories and credit rating agencies. The ongoing review of ESMA's governance and funding structure should therefore include consideration of ESMA's current and possible future expanded role as a supervisor, and whether EU-level supervisory functions for non-bank firms would be better placed elsewhere. In any case, the conferral of supervisory powers needs to be accompanied by adequate resources and financing.

Single supervision could also be warranted for market data providers and consolidators (Approved Public Arrangements (APAs) and Consolidated Tape Providers (CTPs) under MiFID II), as well as benchmark setters under a fully-fledged CMU.[12]

Greater European harmonisation and stronger cooperation could be pursued in the field of financial market infrastructures (FMIs). However, any initiative in this direction should fully take into account the competencies of the ESCB. In particular, any measures to review the current supervisory structure of FMIs (as defined under EMIR, the Central Securities Depositories Regulation (CSDR) or other legislation including related technical standards) must ensure the adequate

[12] This had been envisaged in the original supervisory architecture of the ESAs in 2010, but was in the end scaled back.

representation of all relevant authorities, including central banks under their supervisory, oversight or central bank of issue mandates. Experience has shown that the involvement of all relevant authorities strongly contributes to the quality of FMI supervision by bringing together the specific perspectives and knowledge of all authorities. All relevant authorities should continue to be appropriately involved in setting standards and regulating and monitoring the functioning of FMIs.

The interaction between CMU and shadow banking reform needs to be addressed. This interaction is not addressed in the Commission's Green Paper, but it is relevant. In particular, macroprudential tools are needed to address risks that emanate from gaps in the regulation and/or supervision of banks and markets. These should be addressed by providing appropriate regulation and in order to enrich the macroprudential toolkit available to competent authorities. Placing systemically important non-banks within the parameter of enhanced supervision should be made possible.

Avoiding the build-up of systemic risks requires enhanced risk surveillance, closer cooperation among relevant authorities, including the ESRB, and a broader and strengthened macroprudential toolkit. For parts of the shadow banking sector in particular, no adequate harmonised EU framework is in place that provides for sufficient and consistent supervision of their activities in securities markets. While deeper cross-border markets with increased risk-sharing across the EU are likely to contribute to enhanced financial stability, increased financial integration can also have a negative impact on financial stability. Deeper integration can exacerbate the size and speed of contagion. Moreover, increased financial intermediation outside the banking sector may lead to systemic risks building up in parts of the financial system that are typically less regulated and more opaque, such as shadow banking. Therefore, the development of capital markets could imply new sources of idiosyncratic and systemic risks. Any development in this area has to be aligned with the guidance by international standard-setting bodies. As the CMU agenda is being pursued, attention should therefore be devoted to safeguarding financial stability by providing authorities with the tools to deal with the build-up of risks in market-based activities and entities outside the regulated banking sector.

2 Specific areas where further legislative work is warranted

The following section looks in more details at areas where, from a central bank perspective, measures including legislative action in particular would be warranted for the development and integration of capital markets. The list is not exhaustive and seeks to provide areas where targeted legislative work could be undertaken.

2.1 Company law, including corporate governance

Further harmonisation of cross-border shareholder transparency procedures is necessary. The 2011 T2S task force report on shareholder transparency[13] identified the need to (i) harmonise procedures for exchanging information on shareholders between investor and issuer CSDs (the CSD community (European Central Securities Depositories Association (ECSDA)) could play a role in such harmonisation); and (ii) create International Organization for Standardization (ISO) messages for shareholder identification, potentially by the message standard setting bodies (ISO). The Commission proposal amending the Shareholder Rights Directive (COM/2014/213) already seems to go in the right direction to facilitate cross-border information (including voting) across the investment chain and in particular through shareholder identification.

2.2 Recovery, resolution and insolvency laws

The Commission's work towards a framework for the recovery and resolution of non-bank financial institutions should proceed for financial market infrastructures and systemic insurance undertakings; in particular, steps should be taken towards a comprehensive regime for the recovery and resolution of CCPs. In view of their increased role, appropriate tools should be made available to ensure effective recovery and resolution of CCPs without recourse to public sector money. In this context, CCPs should bear the main responsibility for recovery measures, while resolution authorities will decide on the design and implementation of resolution plans, and will require sufficiently comprehensive and robust toolkits in this regard. The adoption of EU legislation will be essential to ensure sufficiently stringent and consistent recovery and resolution approaches in the EU. EU legislation should also be consistent with applicable international guidance (notably by the Committee on Payments and Market Infrastructures, Board of the International Organization of Securities Commissions (CPMI-IOSCO) and Financial Stability Board (FSB)) and should foster a global regulatory level playing field, i.e. through appropriate recognition rules for third country CCPs.

Further work regarding the insolvency procedures applicable to participants in securities settlement systems operated by CSDs is necessary. Insolvency procedures affect all actors engaged in transfer orders relevant for cross-border settlement in the EU, thus harmonisation would support cross-border investment. For this purpose, specific elements of existing legislation could be amended, for example to address diverging transpositions of the Settlement Finality Directive (SFD), the Financial Collateral Directive (FCD) and the Winding-up Directive

[13] This report is available on the ECB/T2S website at: Link

(WUD) for credit institutions and insurance undertakings concerning their provisions related to designated systems and markets.[14]

In the long term, efforts to review insolvency rules for credit institutions and other entities across Member States should continue. In addition to the Bank Recovery and Resolution Directive (BRRD) and the establishment of the Single Resolution Mechanism (SRM), in some cases credit institutions might still only be subject to normal corporate insolvency proceedings, which are not designed to take into account the special nature of credit institutions. Thus the Insolvency Law Group of Experts should be revived for the purpose of exploring which aspects of insolvency laws – procedural and substantive – can be harmonised, carefully taking into account the general scope of national insolvency law.

With regard to insolvency rules for non-financial corporations, the Commission should conduct further analysis to identify areas of insolvency law where harmonisation would be most beneficial for the development and integration of capital markets. As long as insolvency law remains national in character, it will be difficult for cross-border investors to properly evaluate which risks they take on when they invest in equities or bonds issued by legal entities in other EU jurisdictions. Although it took some 30 years to adopt, the Insolvency Regulation does provide a minimally harmonised procedure at EU level for the insolvency of legal entities established in the EU. However, many issues of substance, such as determining priority (i.e. the ranking of claims), remain anchored in national insolvency law but recognised in the whole EU based on EU law. A potential and immediate market-led initiative would be for originators and issuers to increase the comparability of information on ranking in insolvency of creditor claims across jurisdictions in the documentation they provide to investors.

The procedural efficiency of insolvency needs to be addressed to ensure more efficient debt restructuring and insolvency regimes for firms, which vary widely between Member States at present. The effectiveness of the restructuring regimes is often hampered by slow creditor coordination, a lack of new financing for viable companies undergoing restructuring and an overburdened judicial system. In most cases, restructuring and insolvency regimes could be made more efficient by adopting best practices more broadly. This would include, inter alia, strengthening measures to facilitate out-of-court settlements for viable firms; introducing centralised guidelines for voluntary debt workouts coupled with independent intermediation for larger companies; and establishing standardised voluntary workouts for SMEs. Thus, in the short term, and as a first step, the Commission could play a role in designing, recommending and coordinating best practices across the Member States, using non-legislative initiatives for that purpose, for example along the lines of the Commission Recommendation on a new approach to business failure and insolvency of March 2014. In order to

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[14] In addition, p. 71 of the recommendations of the FSB "Key Attributes of Effective Resolution Regimes for Financial Institutions" of 15 October 2014 (Link), which provides guidance relating to the resolution of participants of all FMIs, should be taken into account.

achieve a fully integrated and effective CMU, the question of whether further legislative or non-legislative measures in this area can be taken for this purpose should be explored.

2.3 Taxation

As outlined above, taxation plays an important role in the incentive structure for investors. While the level of taxation remains a national issue, a more harmonised, streamlined "relief at source" procedure for withholding tax relief should be established. Otherwise, investors and intermediaries will continue to face the costly administrative burden of diverging domestic procedures, excess tax will be withheld and withholding tax at source will be less attractive. While the recommendations issued by the Tax Barriers Business Advisory Group (T-BAG) go in the right direction,[15] little progress has been made on their implementation. T-BAG Recommendation 1 regarding the establishment of a common and standardised Authorised Intermediary Agreement (AIA) between a financial intermediary and a Member State should be taken forward as a matter of priority. The Commission should also consider initiating legislative action towards the implementation of further T-BAG recommendations.

In some cases, interactions between taxation, accounting and prudential rules may also increase the heterogeneity of the impact of the prudential framework between jurisdictions. These interactions should be duly considered.

2.4 Securities ownership rules

Legislative initiatives are necessary for legal certainty regarding the ownership of securities. This applies, in particular, to the law applicable to securities held through securities accounts (at the level of CSDs or other financial intermediaries) and the rights stemming from these securities. A key aspect is the conflict of laws rule, which determines the law governing the proprietary rights over securities. Thus, the conflict of laws rules discussed in the context of collateral (see below) are relevant to securities in general.

3 Improving the cross-border flow of collateral

Efforts in this area should take the form of short-term measures and long-term legal harmonisation, which would ensure the highest degree of legal certainty in a CMU. The following section focuses on short-term measures for improving the cross-border flow of collateral, including financial collateral as defined in the FCD and in relation to relevant securities accounts.

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[15] Report by T-BAG entitled "Workable solutions for efficient and simplified fiscal compliance procedures related to post-trading within the EU" (2013) (Link)

3.1 Measures related to ownership of collateral

Collateral ownership rights and safekeeping arrangements in cross-border transactions need to converge in order to increase legal certainty and confidence. First, when and how securities or collateral are acquired in legal terms (when ownership transfers) should be clarified and harmonised, e.g. at the moment of debiting or crediting an account holder's securities account on the books and records of an account provider. This might benefit from convergence in any revisions to a draft Securities Law Directive (SLD). Second, market participants should be offered transparency and choice by CSDs with respect to whether their collateral is held at a financial intermediary or with a CSD directly. Third, collateral ownership reforms need to be aligned with client money and/or client asset protections under national and EU law. Also, developments in collateral markets have to be taken into account, in terms of asset classes, transmission channels, custody and safekeeping arrangements, and improvements to the resilience of securities settlements systems, as well as revisions that seek greater convergence in the application of relevant conflict of laws rules. Fourth, the ways in which Member States have increased measures since the crisis need to be assessed in the following areas: (i) ongoing transparency obligations for financial intermediaries to provide information in a simple, transparent and standardised format to their counterparties on how these counterparties' collateral is held, how and when it may be used, and which events require notifications as to the usage of collateral; (ii) periodic regulatory reporting by financial intermediaries on client money and client asset positions, and holdings allowing competent authorities to take supervisory action; and (iii) the timely identification, protection and separation of client assets and client money from the insolvency estate of the account provider. The impact of T2S should also be taken into account when determining which measures related to ownership of collateral need to be taken.

3.2 Legal enforceability of close-out netting arrangements on a cross-border basis

The divergence in the transposition and interpretation of the FCD prevents the emergence of a level playing field between various jurisdictions, and needs to be overcome: greater uniformity of legal outcomes needs to be created for default, insolvency, resolution or analogous situations. This is particularly the case when principles of applicable national law, particularly principles of insolvency law such as pari passu, could create legal uncertainty with regard to the enforceability of the close-out netting arrangement clauses in financial contracts and collateral arrangements between financial counterparties. In the short term, greater comparability across contractual and statutory netting, as well as set-off law rights, would be desirable. Convergence of definitions and concepts used in EU legislation in relation to netting and set-off is also necessary.

3.3 Other measures related to the legal enforceability of collateral

As the ECB has stated on earlier occasions, a single conflict of laws rule for financial instrument holdings is required.[16] In cross-border collateral transactions it is of vital importance to ensure that there is legal certainty with regard to the law that governs the validity of the collateral and the rights flowing therefrom. Currently, the place of relevant intermediary approach (PRIMA) is the rule applied in the FCD and SFD. However, this approach only covers certain aspects and a single conflict of laws rule would be welcomed. Thus, the introduction of a clarified connecting factor would be desirable to increase the legal certainty.

The FCD's material and personal scope needs to be expanded. The current opt-out possibility from the personal scope of application of the FCD available to Member States under Article 1(3) creates an unnecessary state of divergence. It results in an application which may, in certain scenarios, require due diligence to be carried out in order to ensure that a collateral transaction would benefit from the FCD's regime. This may act as an obstacle to the free cross-border flow of collateral. Removing the opt-out possibility would create a more level playing field and be inclusive of all types of financial market participant. Finally, expanding the material scope of the FCD to cover all receivables, whether arising under a loan agreement or any other contract, could be assessed for feasibility.

Collateral takers need to be better protected in the context of credit claims. While set-off rights can currently be validly waived by debtors pursuant to the FCD, the divergence in the transposition and interpretation of the FCD greatly undermines the underlying rationale for this provision. The provision was introduced in 2009 to facilitate the use of credit claims as collateral by central banks, and to ensure that debtors are able to validly waive their set-off rights vis-à-vis creditors. This was intended to protect the position of collateral takers. The problem could be mitigated if set-off is fully excluded with respect to credit claims mobilised as collateral with central banks. Furthermore, the protection of collateral takers could be enhanced by the ability to determine, in an objective manner, the law governing third party effects of the mobilisation of credit claims.

3.4 Collateral management arrangements

Collateral handling techniques relating to third party effects for non-marketable assets, specifically credit claims, need to be harmonised. Pursuant to the FCD, Member States may require the performance of a formal act, such as registration or notification, for the purposes of perfection, priority, enforceability or admissibility as evidence against the debtor or third parties. As such, when credit claims are mobilised as collateral, the current handling techniques relating to third party effects are driven by national legal requirements

[16] ECB Response to the Second Public Consultation (2011) concerning legislation on legal certainty of securities holding and dispositions (Link); and ECB response to the First Public Consultation (2009) concerning legislation on legal certainty of securities holding and dispositions (Link).

and still differ across Member States. In particular, the ex ante notification of the debtor, the public registration of the mobilisation of the credit claims as collateral, or the physical delivery of credit claim documentation may be required in order to achieve fully effective mobilisation with regard to third parties, which is an impediment to their efficient use as collateral. Therefore, further harmonisation may reduce costs associated with the mobilisation of credit claims and reduce legal uncertainty (pre- and post-counterparty default), including when such credit claims are mobilised across borders.

Participants' access to securities or collateral service providers needs to be fair and open, as this would support collateral and liquidity management activities, and lead to effective triparty settlement interoperability. This, in turn, would allow participants to choose their preferred triparty agent and securities settlement system. This would improve the CCP-based euro interbank repo market. An appropriate regulatory regime should be complemented by work of the industry on the harmonisation of procedures and practices.

Commercial bank money (CoBM) collateral management arrangements need to be improved. With the increased reliance of market participants on cross-border collateral for secured funding and treasury management operations, constraints related to CoBM processes and cut-off times should be addressed. These constraints are related to the operational processes of counterparties and post-trade settlement practices (which may result in earlier deadlines for same-day settlement).

Risks involved in the reuse and rehypothecation of collateral need to be contained to facilitate an appropriately regulated flow of collateral throughout the EU. Further work should be undertaken by the Commission, taking into account the recent recommendations and any upcoming recommendations by the FSB. This includes the need to prohibit rehypothecation of client assets for the purpose of financing the own account activities of the intermediary.

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