This paper reflects the responses provided by London Stock Exchange Group plc to the Commission's online questionnaire

London Stock Exchange Group Response to the European Commission Green Paper on Building a Capital Markets Union

Part A: LSEG VISION FOR CAPITAL MARKETS UNION

- **We support the Commission's aims to diversify funding sources, reduce the cost of SME risk capital, and address the fiscal bias against equity.** The Green Paper pulls together a number of disparate issues, providing a much needed opportunity to make real progress for the benefit of the Single Market.

- **We believe the key is the development of a new investor environment that will increase the supply of long term patient equity and debt investment.** The EU is not short of capital - it saves €2.7 trillion a year (20% of GDP, compared to $2.8 trillion or 17% of GDP in the US).[1] However, in the EU, citizens tend to invest in property or bank deposits, not use the capital markets to save for their future. CMU must focus on delivering a broader investor base, able to invest long term across the EU. To support this, a recalibration of regulatory risk frameworks (e.g. Pensions, Solvency II) is needed to support public and private markets, together with recognition of the value of intermediaries that can be trusted to market products across borders.

- **The demand side framework for public and private issuers (equity and debt) is largely already in place and no major structural changes are required.** Reviewing existing legislative frameworks and ensuring the proportionate implementation of incoming legislation has a role to play to ensure they support efficient, transparent and liquid markets (e.g. SME Growth Markets). However, the challenge is a cultural issue in terms of issuer aspirations, capabilities and access to advisory ecosystems (e.g. ELITE). These challenges are different across member states, so success should be measured by increasing market depth in all countries (and ex-EU investment), not only by internal cross-border investment.

- **A stronger, internationally competitive supervisory convergence approach is required to ensure consistent application of existing rules.** ESMA should focus on driving through supervisory convergence across the EU. To achieve this ESMA itself will need an enhanced ability to initiate and lead peer reviews across the EU and to ensure compliance by National Competent Authorities. To support the necessary recalibration of the investor environment, ESMA should also be given an international competitiveness objective.

[1] Bank of England

Part B: ANSWERS TO SPECIFIC QUESTIONS

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

- **In general, we support the non-legislative approach of the CMU green paper and the five priorities identified (although we have some questions about the viability and merits of securitisation**). Following the Commission's successful roll out of the Financial Services Action Plan and post-crisis regulatory reforms, further market structure changes are unnecessary for the time being. Please see our analysis for each in answer to Q1. In addition, to deliver CMU objectives, ensuring MiFID and CSD-R Level II measures are calibrated appropriately is a short term priority where these impact the costs of SME capital.

- **In the longer term**, a dedicated proportionate regime for market making in less liquid securities (i.e. on both regulated markets and SME Growth Markets) should be proposed to allow for a coherent horizontal revision of all relevant existing and planned regulatory impacts, including e.g. Short Selling Regulation; Prudential Requirements; FTT; MiFID; CSD-R)

<u>**Calibrating MiFID and CSD-R Level II measures appropriately; potential quick win for CMU**</u> *(please see further detail in response to Q23)*

- **An immediate priority is ensuring that the Level II measures in MiFID and CSD-R are appropriately calibrated** to deliver the objectives of CMU (i.e. lowering the cost of capital, especially for SMEs, and reducing the over-dependence on bank financing). The Commission has an opportunity to take action before the implementing measures are finalised. For example:
    - **Market Makers.** The Commission acknowledges that market makers perform a vital role in in supporting liquidity in vulnerable segments[1]. Action is required to encourage equity market makers to continue to provide liquidity in less liquid securities, typically SMEs - significant numbers of which are traded on regulated markets and may not migrate to SME Growth Markets.
        1. **MiFIR**. As drafted, the deferred publication regime for less liquid equities (MiFIR Article 7 and RTS 8) will reduce liquidity. Market makers will not take on additional risk later in the day because they have insufficient time to manage their risk / trade out of their position before publication.

           Proposed solution: *Table 5, Annexe 2 of RTS 8 should allow market maker trades in less liquids for deferral to at least the end of the day*

[1] P24 of the CMU Green Paper

***following** the trading day (consistent with ESMA approach to illiquid derivatives which allows 48 hours for trades in illiquid derivatives/non-equities RTS9 Art 8(1)).*

II. There may also be unintended negative impacts on existing effective market making resulting from the new requirements (which we support) on investment firms using algo strategies for market making purposes.

Proposed solution: *either*

- ***a)*** *(Preferred) this must be made clear in the RTS (please see LSEG's fully revised RTS 15 submitted to ESMA [attached]);* ***or***
- ***b)*** *If not, the RTS must explicitly allow for the two tiers of market making to avoid damaging consequences to existing market structure. To preserve existing market quality, LSEG must be able to continue with current market making schemes for non 'algo market makers' (A17(3)) requiring* ***90%*** *daily presence.*

III. **CSDR**. Market making in less liquid equities will also be impacted by the settlement discipline proposals (CSDR Article 7 and its draft RTS). As drafted, these do not provide a proportionate penalty regime for market makers in less liquid securities.

Proposed solutions:

- *The cash penalty regime should distinguish between liquid and less liquid securities. A basic penalty rate should be applied to ensure that trading in less liquid securities (typically SMEs) is not discouraged.*
- *The level of cash penalties also needs to be considered in terms of the amount of time the buy-in process can continue.*
- *CSD-R must be recast to explicitly recognise that less liquid securities are traded on both regulated markets and SME Growth Markets.*

- **SME Investment Research** - *(please see our response to Q.2 for more detail)*
  The Commission must actively manage the risk of any potential negative impacts around the already smaller size of the market in the production and distribution of research on SME securities that could result from the MiFID Level II delegated act proposed on inducements and research. We foresee some or all of the following consequences from such proposals:
  - Reduced research coverage of small cap securities; this could adversely impact the ability of investors to understand and invest in small cap securities.
  - SME issuers may be forced to pay for their own research, which is often viewed less favourably than independent research

coverage. It will also result in issuers facing higher costs of coming to market and maintaining a listing.

Proposed solution: *To better understand the impacts of changes to the funding of the research market, we would advocate an incremental approach, so that the impact of the proposed changes can be assessed and unintentional damage to the market can be avoided.*

Please also see our response to question 5 in relation to the role of market infrastructure in helping to facilitate investor access to SME investment opportunities.

Lowering barriers to accessing capital markets (Commission Priority 1)

- **Further market structure changes are unnecessary following the implementation of the Financial Services Action Plan**. The current legal framework ensures harmonisation of relevant domestic legislation and has led, post MiFID, to the development of a true European secondary market for blue chip equities. However, for SMEs, the comprehensive and structural reform has proven to be insufficient to produce a real convergence of capital markets. SMEs face ongoing challenges in terms of access to long term financing opportunities. These challenges prevent them from competing and growing more rapidly and are exacerbated by cultural barriers: lack of information or skills, insufficient networks, and difficulties in reaching international pools of liquidity. This is mainly due, on the one hand, to the traditional shortage of funding and channelling of funds for SMEs, and on the other hand, to the lack of a wide investor base, as the buy side continues to remain fragmented, local and insufficient in volume.

- **We welcome the SME Growth Market proposals created through MiFID.** There are at least 19 markets that are currently operating across the EEA which potentially could fall under the SME Growth Market regime (see appended list). They are home to over 3000 companies with a combined market capitalisation of over €200 billion. To ensure their success, we need (1) to expand the supply of equity finance to small and medium sized businesses across the European Union and (2) to increase the investor base, including an increase in those willing to invest for the long term.

- **We support the Technical Advice of ESMA on the SME Growth Market regime.** These markets should be allowed to develop with flexibility under market operator control in order to be best tailored to domestic markets and help create local equity cultures and ecosystems. We do not support recommendation SMS15 of Finance for Growth (Giovannini/Moran). The key factor in promoting SME access to capital markets is to develop strong local ecosystems across the capital markets community, and between all elements of the funding ladder from seed funding, to business angels, venture capital and public markets, with clusters of expertise to support strategically important sectors (e.g.

Technology in London; Luxury Goods in Milan). We believe developing the expert advisory base in specific sectors and markets is a more effective approach than assuming increased liquidity and investor participation will follow automatically from top down attempts to harmonise or integrate SME markets.

Widening the investor base for SMEs (Commission Priority 2)

OUR KEY RECOMMENDATION: A NEW INVESTOR ENVIRONMENT

The EU is not short of capital,[2] – today European citizens tend to invest in property or hold deposits with banks, instead of seeking investment returns through capital markets. CMU is an opportunity to create a 'new investor environment' in Europe - broadening the investor base and encouraging more long term investment in equities on a cross-border basis. Areas for the Commission to explore include:

- Review of any potential regulatory constraints on long-term investment in equities (e.g. Solvency II, AIFMD, UCITS)
- Considering a quality badge for trusted, "high quality" intermediaries
- Ensuring that European citizens are encouraged to save for their future
- Supporting the private placement market (e.g. reforms to Capital Requirements Regulation - see our responses to Q4 & 25)

- **The review of UCITS directive presents an opportunity to identify ways to attract dedicated UCIT funds for small caps**, creating a new category of UCITS dedicated to investment in SME markets with specific conditions and ability for the products to be marketed to retail investors.

- **Retail investors should be encouraged to participate, both directly and also through intermediaries in whom they can trust.** For the vast majority of retail investors, capital is most efficiently deployed though intermediaries. CMU should aim to ensure that a broad range of investors are able to access markets in the way most appropriate for their investment needs. High quality intermediation will be as crucial as the diversification and aggregation that allows investors to back long term and SME investments on a portfolio basis. CMU needs to look towards a new "high quality" intermediation sector in which investors can have confidence and trust.

- **Creating new categories of investors with a long term vocation and strategy should be incentivised with fiscal measures** (e.g. EFSI and similar national initiatives, such as

[2] Europe saves €2.7 trillion a year – 20% of EU GDP. In the US by contrast saving is $2.8 trillion – about 17% of GDP - Speech By Sir Jon Cunliffe: Financial stability, the Single Market and Capital Markets Union, 20/01/15

"Fondo di fondi" in Italy)[3]. A collective investment approach by multiple actors (including banks, pension funds, insurance companies, alternative funds, etc.) is important for achieving scale and market penetration. The mandate should be to provide growth capital, not buy-out funding, to start-ups and early stage companies, and also to the wider range of SMEs which have a clear business model, a path to rapid growth and a strong likelihood of follow-on investments.

Building sustainable securitisation (Commission Priority 3).

We do not provide a separate response to the Commission's Consultation Paper on "High Quality Securitisation"- our comments here represent our views.

- **Securitised SME loans are heterogeneous assets tied to the originating bank and are difficult to price or credit score on an aggregate basis, negatively impacting investor appetite and liquidity.** There are considerable challenges in achieving the degree of homogeneity required in the underlying assets for a pan-European regime (e.g. national legal frameworks relating to insolvency and company law). In any new regulatory framework, in common with other securities under MiFID, we believe consideration should be given to whether securitised products should be traded on transparent regulated markets and be subject to clearing and reporting to ensure that instruments of this type cannot contribute to financial instability as they did in the lead up to the financial crisis in 2008.

- **While we would agree that it is possible that SME securitisation could provide liquidity, it is difficult to envisage it providing adequate transfer of risk**, unless it truly provides capital release for banks that are able to allocate it for real economy lending. There are three distinct types of SME securitisation, only one of which would in our view provide a workable solution (the third - securitisation of more homogenous assets) :
  I. **Short-term receivables from SMEs**, funded via asset-backed paper, much like factoring the receivables owed to the SMEs. This results in no capital transfer for the banks, because they have to provide a long stop guarantee in any event.
  II. **SME loan securitisation.** It will be very difficult to get homogenous and consistent risk standards. Risk transfer and capital release from banks would therefore be difficult to achieve. A critical mass of SMEs securitisations is required, effectively achieved by setting up dedicated government- sponsored bodies, as was done to expand the secondary markets of mortgages in the US (i.e. Freddie Mac and Fannie Mae).

[3] Launched in the context of the project "piùBorsa" described in the Memorandum signed by Consob and by some of the main representatives of the Italian industry to facilitate capital market access by medium-sized enterprises.

III. **Securitisation of more homogenous assets**, e.g. mortgages or consumer finance such as credit cards. This is more realistic. These are capable of being grouped into tranches based on the potential level of risk and would provide capital release for the bank, who in turn would be able to reassign capital to SMEs.

- **SME hypothecation.** To achieve the CMU objective, we suggest that any measure allowing securitisation should require that a proportion of the funds released to the banks or securitisation issuers is allocated and actually made available exclusively for investment in the target sectors of SMEs etc. (consistent with the restrictions on, for example, investment by ELTIFs).

Boosting Long Term Investment. (Commission Priority 4)

- In its Green paper, the Commission appears to take the view that ELTIFs are the policy response to encouraging more Long Term Investment. While we agree that ELTIFs are an important component, they are only part of the answer- Long Term Investment in our view relies on creating a new investor environment more generally by a) recalibrating regulatory constraints; b) recognising the role of intermediaries that investors can trust and c) ensuring that citizens are encouraged to save for their future.

- Please also see our response to question 3 on encouraging take up of ELTIFS

Developing European Private Placement Markets. (Commission Priority 5)

- We agree with the Commission that the development of private placement markets should be a priority for CMU, as part of a drive to improve the investor environment.

- Please see our responses to question 4 and 25.

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

- **SME Asset Class.** Investors should not be dissuaded from investing in growth companies by any actual or perceived regulatory or conduct of business barriers. In this respect, a dedicated 'SME asset class' could help tailor regulation to focus investment in these high growth companies as well as equity research and credit information coverage.

- **Harmonised Terms.** The definition of appropriate common terms should be harmonised at European level. Research and information providers should be required to define terms in an alternative way only where the definition differs from the EU definition. This will help to streamline costs and manage any language barriers. Please also see our response to

Q6 on bond standardisation (in terms of documentation and processes rather than instrument structure)

- **SME equity investment research** is as important as credit information. The Commission weigh carefully of the risk of any potential unduly negative impacts around the already smaller market in the production and distribution of research on SME securities that could result from the MiFID Level II rules proposed on inducements and research. We foresee some or all of the following consequences from such proposals:
    - Reduced research coverage of small cap securities; this could adversely impact the ability of investors to understand and invest in small cap securities.
    - SME issuers may be forced to pay for their own research, which is often viewed less favourably than independent research coverage. It will also result in issuers facing higher costs of coming to market and maintaining a listing.

Proposed solution: *To better understand the impacts of changes to the funding of the research market, we would advocate an incremental approach, so that the impact of the proposed changes can be assessed and unintentional damage to the market can be avoided.*

Please also see our response to question 5 in relation to the role of market infrastructure in helping to facilitate investor access to SME investment opportunities.

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

- **ELTIFs should be made available to all investors, not just those with a portfolio of over €100,000k.** Consistent with our view on changes to the Prospectus Directive (see response to Question 5), appropriate investor protection can be ensured by requiring them to be sold either on an advised basis or by triggering an "appropriateness test" to be conducted by distributing investment firms before being able to provide execution services (under Article 25(3) of MiFID II). Listing of ELTIFs would enable easier access for retail investors.

- **Appropriate fiscal incentives should be encouraged in order to support ELTIFS.** For example, access to UK Investment Trust status, which grants capital gains tax exemption when the trust sells individual company shares.

- **There needs to be greater clarity on the advantages of ELTIFs over other AIFs approved under AIFMD.** Currently, market participants report awareness that the funds have additional restrictions to AIFMD funds (i.e. 70%-invested in eligible assets). However, there is little understanding of the advantages that ELTIFs offer to investors.

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

Yes- we suggest at least the following two actions:

- **Capital Requirements Regulation.** Re-calibrating the requirements under Article 122 which impose a higher capital charge for firms investing in mid-sized businesses that will have a low credit rating when compared to established businesses.
- **Prospectus Directive.** We support the raising of the thresholds for producing a prospectus, which would also help and equity markets. The "amount raised" threshold should be raised from €5m to €20m and the number of investors from 150 t0 500, consistent with the US JOBS Act.

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

- In responding to this question, we discuss issues around SME Growth Markets and the role of market infrastructure in supporting advisory ecosystems that enable SMEs to transition up the funding ladder (e.g. LSEG's ELITE programme.)
- **Please also see our responses to Q.19** (How market operators can provide direct access between issuers and retail investors)

  <u>**5.1 SME Growth Markets**</u> – *please see the appendix for an indicative list of potential future SME-GMs*

- **If implemented in line with the MiFID Level 1 mandate and ESMA's advice , we believe that the SME Growth Market (SME-GM) regime should provide a suitable regulatory environment "to facilitate access to capital for SMEs** and to facilitate the further development of specialist markets that aim to cater for the needs of SMEs"…and "…the requirements applying to that new category of markets need to provide sufficient flexibility to be able to take into account the current range of successful market models that exist across Europe. They also need to strike the correct balance between maintaining high levels of investor protection, which are essential to fostering investor confidence in issuers on those markets, while reducing unnecessary administrative burdens for issuers on those markets." (MiFID recital 132).
- **The requirement for a Prospectus should <u>not</u> be extended to admission to trading on MTFs / SME-GMs, even in 'lite' form** (there are prescribed circumstances where a prospectus is already required for public offers by issuers, so extending the requirement is not necessary). LSEG supports ESMA's advice that it is important to take an outcomes-focused approach and that each market operator should create, under the supervision of the national competent authority, an appropriate framework that works for participants

(e.g. leveraging the NOMAD (Nominated Adviser) and market-maker model), based upon domestic market practice, facilitating sufficient differentiation between the SME-GM and any existing Regulated Market/s. This will provide SME issuers with a choice of preferred venue, tailored to their specific needs. SME Growth Markets need to be supported to grow and with a view to future harmonisation potential - but only in the long term – and with flexibility at the time of introduction of the new regime.

- **The Commission should not seek to continue with the alternative maximum harmonisation approach for SME-GMs it proposed in a recent MiFID Level II non-paper** (and which it now appears to be seeking to introduce as part of the Prospectus Directive review). This is contrary to the MiFID Level 1 mandate (which refers to common standards, not common rules). Precise requirements to meet a common standard are likely to differ, on a case by case basis, from one market to another depending on the size and stage of development of the issuer, advisory and investor communities as well as the range of alternative funding options available. These should be a judgement for the individual market in close cooperation with the national competent authority, rather than "one size-fits-all".

- **Dual listings should be driven by commercial rationales rather than political or jurisdictional pressures.** For that reason, we do not support the associated recommendation SMM14 in the Finance for Growth (Giovannini/Moran) report, also echoed in a Commission non-paper on SME Growth Markets. Intra EU dual listings should not be considered a success measure or end in themselves for SMEs or larger companies. The business case for dual listings must be able to deliver a widening of the investor base or allowing access to deeper pools of liquidity. Many of LSEG's dual listings are generally with emerging markets or markets in different time zones which have clearly differentiated pools of capital rather than with other EU member states. This is also true for example of the Frankfurt exchange, many of whose dual listings are also listed in Canada. A good example of where intra-EU dual listing did make commercial sense for all participants is infrastructure privatisation; for example, RomGaz was dual listed in London and Bucharest in 2013, raising €476m in an oversubscribed offer priced near the top of its marketed range. The domestic investor base was well complemented by the deep pools of liquidity and oil and gas investment expertise present in London.

- **We welcome that ESMA has expanded the possibility of SME Growth Markets to include non-equity MTFs.** Please see our response to question 6 for a case study of ExtraMOT PRO, LSEG's Italian Corporate Bond Market for Professional Investors.

- **Prospectus Directive.** Please also see LSEG's detailed response to the review of the Prospectus Directive - in respect of IPOs on Regulated Markets (support for exempting secondary issues; allowing Prospectuses to be pan-EU documents; removing incorporation by reference requirements; harmonising terms at EU level and for non-equity, abolition of the €100k retail/wholesale threshold).

5.2 The role of market infrastructure in supporting advisory ecosystems that enable SMEs to transition up the funding ladder

- **CMU should support the development of SME advisory ecosystems of issuers, investors, advisors, entrepreneurs, academics and European centres of innovation such as science parks (e.g. ELITE - see box).** We support Recommendation SMS10 of the High Level Expert Group of the Council Report 'Finance for Growth' (Alberto Giovannini /John Moran) and Recommendation 8 of The Scale-Up Report on UK Economic Growth (Sherry Coutu CBE) in this respect. As they grow, SMEs use a combination of bank finance, seed capital, business angel finance, venture capital and ultimately public markets. Each type of investor is interdependent, as they must be confident that they can realise their investment at a later stage (and reinvest in the next generation of entrepreneurs). However, SMEs often do not have the aspiration, confidence or understanding about the long term growth financing strategies that are available to them and often need practical help to acquire the financial and organisational skills to make themselves suitable and attractive to the widest possible range of investors. In it's communication on Long Term Financing, the Commission committed to producing an assessment of best practices on helping SMEs access capital markets and this report deserves to be acted upon by policymakers once it is available.

- **CMU should create a positive environment for companies seeking growth capital and look to create more of an "equity culture" similar to that in the US. To support** SMEs with the potential and desire for growth (i.e. 'scale-ups'), all elements of the funding ladder need to work together, from seed funding, through business angels, venture capital and public markets, with clusters of expertise to support strategically important sectors (e.g. Luxury Goods in Milan; Technology in London, Manufacturing in Germany). Markets benefit from being more diversified and, as a consequence, less cyclical, and we believe that developing the expert advisory base and equity cultures in different Member States is a more effective approach than pan-European issuance platforms; structural change is not the issue or the solution.

Case Study:

ELITE – supporting SME advisory ecosystems to help growth companies navigate the funding ladder

- **ELITE** (launched by Borsa Italiana in 2012) is growth coaching programme for European high growth businesses, deeply rooted in each domestic market through partnership with local organisations while also enabling SMEs to position themselves for the international financial community.

- ELITE facts

  - 271 companies, 150 advisors, and 80 investors are part of the ELITE community across the EU (Italy, UK, Spain, Romania, Greece, Germany, France, Poland, The Netherlands, Ireland, Israel, Switzerland, Slovenia, Portugal, Croatia, Finland, Slovakia.)
  - 88,000 employees of ELITE companies; €22.6bn total revenues of ELITE companies
  - Achieving its first IPO, with 15 more intending to IPO; 10 bond issuances; 13 private equity deals; 35 M&A/JV deals.

- Through ELITE, entrepreneurs gain the information, contacts and possible funding as their business matures, with access to the sort of expert advice and support normally only available to large firms.

- ELITE is designed to help SMEs prepare and structure for the next stage of growth through the access to long term financing opportunities. It is dedicated to SMEs, with a sound business model, clear growth strategy and a desire to obtain funding in the near future.

- ELITE offers an innovative approach, including a training programme, a working zone supported by a tutorship model and direct access to the financial community through dedicated digital community facilities.

- ELITE is “capital neutral” to any financing opportunity, providing access to Private Equity and Venture Capital funds, debt products, etc. The long term objective of ELITE is to improve SMEs access to more sophisticated skill-sets, network and a diversified capital pool in order to accelerate growth opportunities.

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

- **Standardisation of information and processes is distinct from standardisation of instruments.** We support action in the short term to introduce measures to support standardisation of information and processes (see box for a case study from the Italian market). However, standardisation of instruments is substantially more complex and uncertain. We would support measures that incentivise issuers to further standardize issuance (e.g. exempting them from producing a prospectus for “tap” issues of existing bonds), but we would not support the introduction of any obligation or disincentive for less standardized issuance as these bespoke instruments will reflect the particular funding requirements of the individual company.

6.1 Standardisation of instruments

- **Equity and bond markets are different and do not share the same characteristics or requirements.** The equity and bond markets arose out of, and serve, different issuer and investor needs. These differences should not be overlooked in the interests of "standardisation" or a "one size fits all" philosophy. On this basis, we analyse the potential advantages and disadvantages of standardisation of instruments , which is informed by feedback from market participants and the UK's Fair and Effective Markets Review:

Potential Benefits

- **Ready comparison** between issuers and financial instruments traded
- **Liquidity.** Could potentially increase liquidity by reducing the number of unique instruments.
- **Electronic Trading.** Enhanced trading volumes through greater use of electronic trading platforms for standardised instruments (using order books); improved ability for dealers to make market and enhanced surveillance capabilities (to detect and deter market abuse.)
- **Lower costs (for some issuers, potentially).** Lower financing, rating and issuance costs for corporate borrowers and lower transaction costs for investors.

Potential Disadvantages

- **Might not be able to reflect the needs of the individual issuer whose funding needs will be specific to its circumstances.** Assuming an issuer who has decided to issue debt and not equity has a specific need that is served by debt, the issuer will want to be able to determine characteristics which will fit with its financial planning and management plans (e.g. amount raised; coupon; conditions; denomination; timing and maturity -see more detail)
  - **Timing.** The issuer needs to issue at the right time for the issuer – according to its financing or refinancing needs; these are driven by the business's growth/requirements as it seeks to fund development opportunities; standard issuance timings would seem counter-intuitive.
  - **Maturity.** Staggering of maturity dates is a key refinancing risk reduction technique of issuers; what if an event closed the market at a standard re-issuance window?

- **Choice of structuring of products is very important to maintain a broad based issuance market.** Leveraging new ideas/structures keeps the market growing/available for issuers who perhaps require something different (e.g. certain forms of hybrid capital will appeal to certain types of issuer at points in their evolution – or in fact new security features might be the only game in town for some issuers at a point in time)
- **Costs.** It is not clear how standardisation would affect costs of issuance.

- **Market access** for various types of issuer will vary (i.e. frequent larger issuers will enjoy good access; smaller/weaker, infrequent or debut issuers need to take windows of opportunity to get a deal done – would standardisation impact this?
- **Long Lag.** No likely impact on the existing range and scale of bonds, so uneven market for many years to come, reducing any immediate gains

6.1 Standardisation of information / processes

- **We believe that standardising elements of information provided on fixed income securities and the processes for distribution and trading can broaden the investment base.** As an example of how technical standardisation of this kind can work, making the investment chain as efficient as possible, the box presents a case study of the ExtraMOT Pro market in Italy. Member states should look to the impact of important new changes in the regulatory Italian framework[4] that enabled these changes to take place.

Case study:

ExtraMOT PRO – Standardised processes allowing for more efficient bond listing – *to be presented at the Commission's Bond Standardisation Workshop on 20th May*

- In March 2013 Borsa Italiana launched the new Professional Segment of ExtraMOT to facilitate the access to capital markets for Italian private companies other than micro and to direct large institutional investors, including foreign investors, toward Italy's real economy.

- To date **91** companies have approached the bond market, raising a total of about **5** billion euro and only **11** companies were listed at the time of admission to trading of the bond.

- ExtraMOT has provided a strong contribution in terms of procedural standardization ensuring rapid and clear admission at low cost. It has defined essential listing and information requirements that ensure a minimum and predetermined set of information is provided to the investor[5], while allowing the company and the counterparties the flexibility typical of the private placement where commitments and conditions are set out together in the light of the particular characteristics of the company and of the transaction itself.

[4] In 2012, "Decreto Sviluppo ", "Decreto Sviluppo-Bis", later in the course of 2013 and 2014 "Piano Destinazione Italia", "Decreto Competitività 2014" and IVASS Regulations.

[5] Publication of the annual financial statement for the past two years, the last of which audited, the admission document with minimum contents defined in the Market Rules starting from the European standard prospectus for the listing.

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

- **The current system of third party ESG standards verification could be improved further**. We have noted efforts spearheaded by organisations such as ICMA to develop standardised guidelines and principles. We would note that there is a substantial amount of material on green attributes already available, and we suggest this is taken to the next stage by also allowing issuers also to have the ability to report directly to the market.

- **FTSE International Ltd (part of the LSE Group) is currently developing a self reporting tool for issuers, so that investors can ultimately decide and the market can determine the best way to verify the green credentials of bonds.** FTSE International Ltd has developed a web-based platform that looks at the low carbon activities of approximately 9,500 companies over the last 7 years, which is in a trial phase. It has identified approximately 2,000 companies that have revenues which contribute to the 'low carbon economy' through one or more of FTSE's new 60 industrial green sectors. A large number of institutions have shown an interest in, and support for, the platform; the World Bank had initially contacted FTSE International Ltd to ask for its input in building some global operating infrastructure to enable the green bond market to grow, and this project has been developed in response to this need. The platform is also open to bond issuers who can disclose information as to which green activities or assets the proceeds of their bond were applied.

- **Building on the EU Directive on non-financial and diversity to further improve ESG data consistency.** Firstly there is a need to extend the scope to non-listed entities to ensure a level playing field. Secondly, investors need internationally comparable ESG data, so corporate reporting should be based on international frameworks and standards, not national codes. The comply-or-explain approach is appropriate but more detailed and specific guidance, drawing from international standards, is required on an industrial sector basis to improve consistency and comparability of data. In addition, a more detailed revenue breakdown needs to be encouraged allowing investors to more precisely attribute industrial activity, including low carbon sector attribution.

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

- **Please also see our response to Q.5**. – the regulatory environment around SME-GMs should be flexible

- **We do not believe a new accounting standard for SME Growth Markets is required or desirable.** It would be better to maintain flexibility for Member States to encourage SME-GM take up (consistent with ESMA’s Technical Advice.) The lack of common standards is not the reason for the sub-optimal levels of cross-border SME investment; rather it is a cultural and educational issue.

- **SME markets are at varying stages of maturity and they must be allowed to use frameworks that are appropriate.** For less mature markets, this means tailoring to issuers, but for more mature markets (e.g. AIM) it makes more sense for investors to be able to make ‘like-for-like’ comparisons with regulated market companies, as the investors are often the same. A new regime would create uncertainty and inhibit SMEs from progressing up the funding ladder. SMEs would be required to adopt IFRS once they reach a certain size in any event, with the result that they would incur significant cost and effort in the transition from any different accounting standard for SMEs. In addition, it could constrain the companies in their third country/international fundraising as they would not be using an internationally recognised standard.

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

- **We support the UK FCA approach to the regulation of crowdfunding.** Under this framework, where no advice has been provided to retail clients, the FCA must apply the appropriateness test required under MiFID Article 25 (3), so all firms (both MiFID and non-MiFID) would need to check that clients have the knowledge or experience to understand the risks involved. In other circumstances, advice is mostly required (except if, for example, a professional investor or subject to other limitations) and providers must be authorised. We also support the IT CONSOB framework which authorises both MiFID and non-MiFID portal operators and provides for specific transparency requirements and conduct of business rules to balance flexibility and investor protection. Appropriately regulated, crowdfunding has an important role to play as part of a diverse financing environment for growing companies.

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

- **CMU must tackle any potential regulatory constraints that discourage long term investment, e.g. by pension funds and insurers.** In the first instance, we would encourage the Commission to review capital frameworks, such as Solvency II, to identify any prudential disincentives for long term investment.

- **The pool of available investment capital is smaller in Europe when compared to the US.** As demonstrated in the AFME study, "Bridging the Growth Gap" (Feb 2015) sources of equity funding for SMEs are underdeveloped in Europe. By comparison, small SMEs, start-ups and entrepreneurs in the US benefit from more diverse financing sources which provide a significantly larger proportion of funding than in Europe:

    - US private equity and venture capital funds had €488bn to invest in 2013 vs only €245bn in Europe
    - In the US 33% of SME financing is provided by private persons' wealth vs 9% in Europe - there is a difference in the way in which investors, such as pension funds, must hold their investments/liabilities.
    - €26bn was invested by venture capital firms in SMEs in the US in 2013, against only €5bn in Europe
    - Over the same period, €20bn was invested by angel investors in US SMEs, versus only €6bn in Europe

- **The risk charges that apply to long-term investments under Solvency II are crude and relatively punitive.** Following a call for advice by the European Commission, EIOPA started work in March 2015 on infrastructure investments by insurers[6]. The study will concentrate on a more granular treatment of infrastructure investments within the regulatory framework of Solvency II. In the course of its work EIOPA intends to:
    - develop for regulatory purposes a definition of infrastructure investments that offer predictable long-term cash-flows and whose risks can be properly identified, managed and monitored by insurers;
    - explore possible criteria for this new class of long-term infrastructure assets covering issues such as standardisation and transparency;
    - analyse the prudentially sound treatment of the identified investments within a risk based supervisory system, focusing on their specific risk profile.

We look forward to the outcome of this work, and ultimately to rule changes that will improve the ability of insurers to make the type of long-term investments that are critically needed in order to broaden the investor pool, enhance the creation of jobs and contribute to growth in the EU.

- **Please also see our responses to Q1, 11 and 12**

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

- This is a matter for fund managers.

[6] https://eiopa.europa.eu/Pages/News/EIOPA-prepares-discussion-paper-on-infrastructure-investments-by-insurers.aspx

- **Please see our response to Q. 25 on consistency of supervision**

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

- **SME asset class.** A dedicated 'SME asset class' should be identified as to allow for future tailoring of regulation to focus investment in and research coverage of this vital group of companies.

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

- As suggested in our response to Question 10, the issue is not so much the pension products, but the pool of capital available for investment

- **Increasing pension investment would create a greater pool of investable assets.** This would be a substantial secondary benefit to the primary pension policy goal of increasing retirement income for European citizens.

- **Member states should look to the example of the introduction of automatic enrolment into workplace pension in the UK** (with compulsory minimum contributions from both employees and employers). The key challenge in increasing pension participation and savings rates is not principally product design (although there is a debate about costs and market structure) but rather individual behavioural failings and poor decision making (e.g. consumers spend more time choosing between televisions than pension products, even though pensions are of significantly greater importance.) As a result of the introduction of automatic enrolment in the UK, pension funds are projected to significantly increase their investment in equities both in asset allocation terms and in absolute terms.

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

- Venture Capital funds are better placed to comment, however LSEG supports any measures that would enhance the efficiency and scale of the wider funding ladder.

- Please also see our case study on the inconsistent application of AIFMD across the Single Market in Q26.

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

- **Venture Capital benefits from a well functioning funding ladder** (please see our response to question 5). Increasing the attractiveness of the public markets through a well calibrated regulatory and fiscal environment (and growth coaching programmes like ELITE) will enable venture capital funds to realise their investments after medium to long term holding in order to enable them invest in the next generation of entrepreneurs.

- **All stages of the equity funding ladder are interdependent - a thriving VC sector depends on well functioning public markets and vice versa.** In this respect, we are pleased to note the increase in VC backed IPOs coming to market and the facility for VC to hold back a portion of their holding for a secondary sell down at a later stage (used by 14 issuers over the last 6 months alone) – highlighting again the crucial role of liquidity in an effective market which delivers a lower cost of capital. 2014 saw a favourable market for private equity-backed IPOs on the London market with **32** businesses successfully floating and raising a combined **£9.3bn. Over 50%** of money raised in 2014 came from financial sponsor backed IPOs. In 2015, Hungarian Airline WizzAir raised €425m at IPO in London, sponsored by Indigo Partners.

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

- Please see our responses to Q9 (crowdfunding) and Q19 (retail investment)

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

- Please see our response to question 25 (supervisory convergence)

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

- **MiFID already provides an appropriately enhanced investor protection environment, avoiding the need for any further measures in the context of CMU.** The Commission should weigh carefully the unintended consequences of any further enhancements to ESMA's investor protection powers, especially when the new measures under MiFID are yet be given a chance to work. It is the quality of the supervision of these measures that will be important, rather than the introduction of further regulation.

- **Under MiFID, the focus of investor protection has rightly moved away from disclosure and onto appropriate distribution with effective supervision.** For example, the appropriateness test requirements under Article 25 (3) mean that firms need to check that clients have the knowledge or experience to understand the risks involved.

- **Please also see our response to question 25.**

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

- **Supporting a "high quality" intermediation sector in which investors can have confidence is key.** Both direct and intermediated retail participation have a strong role to play in increasing the diversity of investor participation through CMU. The two channels are complementary, although intermediated investment will always represent the larger proportion (as is the case in the US). Please also see our comments in response to question 1.

- **Market operators can develop existing technology platforms and connections to help solve the existing funding gap.** As an example, Borsa Italiana has a service to allow direct offers of financial instruments on the Exchange bringing them to market at a lower cost. The distribution of retail government bonds known as BTP-Italia (see box) shows how a primary market can use a platform of a secondary market for distribution[7]. The new procedures introduce a market phase during which the issuer/offeror, directly or through an intermediary, offers the financial instruments to all the participants in the market, at the same time as the admission to listing.

Case Study:

[7] According to the new procedure, in the context of the process of admission to listing, the issuer/offeror can use the Borsa Italiana markets for the distribution of financial instruments. Borsa Italiana, once verified the admission requirement of the issuer/offeror and of the financial instruments, admits to listing the financial instrument and starts the sale on the market. At the end of the sale period, in case of positive result and conditionally to the respect of the requirements foreseen by the Exchange Rules, [the admission becomes definitive] and Borsa Italiana establishes the date for the start of transactions on Borsa Italiana.

MOT & BTP Italia - The distribution of retail government bonds shows how a primary market can use a platform of a secondary market for distribution.

- The new MOT distribution model for primary market issuance is designed to facilitate the distribution of a specific type of Italian Government bonds (so called "BTP Italia"). These are inflation-linked government bonds designed to meet the needs of retail investors and issued directly through LSEG's MOT platform rather than the traditional auction/syndication mechanisms. Retail investors can purchase the securities at issuance from their bank/broker branches or through any internet banking system that offers an online trading feature. A dealer appointed by the government is obliged to sell these bonds at a price of 100 to all bidders. Italian banks, which facilitate direct market access (DMA) for retail investors make such a system possible. The minimum purchase amount at issue is €1,000; a bonus payment of 0.4% is paid on the nominal value (non-revalued) of the principal to those investors who purchase the bonds during the primary market offer period and hold them until maturity. The scheme is aimed at incentivising retail participation in government bonds' primary market issuance. The orders are collected directly on the Exchange's platform and banks route the orders onto the Exchange, and a number of banks are chosen as exclusive joint distributors for each issue.

- The Italian government has issued 8 bonds using this model, most recently 13-16 April 2015, raising more than €103 billion in total. The largest issue so far (November 2013) raised over €22 billion through 300,000 orders in just two days; the high number of investors helped to create an extremely liquid market for this bond. During the last issue, the government had two separate windows for retail and institutional investors, with a two-day offer period open only to retail participants, followed by a single day dedicated to institutional investors. On 16 April 2015, the Italian Treasury announced the results of the most recent BTP Italia issue which raised €9.4 billion. In April 2014, Borsa also had the first corporate issue based on the same distribution model through the MOT platform, and again open to both retail and institutional investors. This was an issue from an Italian private equity company (Tamburi Investment Partners – TIP) that raised €100 million in literally just a few seconds, through a 6yr 4.75% bond.

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

- **Tax efficient wrappers- UK Investment ISAs.** All adults in the UK have a (current) £15,240 annual ISA allowance (and children at £4,080), which is exempt from income tax (provided it is reinvested) and capital gains tax. These have proved a hugely popular and trusted brand, with over €250bn invested in securities (another €250bn in cash). Following a recent change to allow SME securities to be held within an ISA, €6bn of investments were transferred to these SMEs in the first year of the change, helping to support liquidity and confidence amongst issuers and helping to give individual citizens a stake in the future growth of some of Europe's most exciting companies.

- Please also see our response to question 19 in relation to MOT and BPT Italia

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

- **We strongly support the objective of increasing the EU's international competitiveness.** In this context, we would suggest that the Commission considers giving ESMA an explicit objective for competitiveness (e.g. "ensuring well-functioning and competitive capital markets to support sustainable growth in the economy of the EU"). It should also consider withdrawing its FTT proposal, which, in the absence of a global agreement on an FTT, actively undermines the EU's attractiveness as a place to invest for third country investors. Going forward, all Single Market measures should concentrate on the potential benefits to the real economy (whilst also taking account of consumer protection and systemic risk.)

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

- **We welcome the Commission's increasingly pragmatic and flexible approach to the recognition of third countries.** It is essential that the EU has an open and co-operative relationship with other jurisdictions, including the US, if it is to facilitate EU firms' access to strongly growing markets in third countries. Sensible recognition and registration arrangements that stop short of demands for full "equivalence" with EU legislation are to be welcome (e.g. IOSCO Principles for Financial Benchmarks and MiFID 2 third country regime). The Commission may consider a future Omnibus Directive on Third Countries to rationalise the regime across existing and future dossiers.

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

- We welcome the acknowledgment by the Commission in the CMU Green Paper of the role of market makers in supporting liquidity in vulnerable segments (p24). In this section we discuss the importance of equity **Market Making** in providing liquidity and we provide our recommendations on what needs to be done to ensure that Market Making is able to support efficient markets. We also discuss the importance of a harmonised post trade data feed and what needs to be done to ensure a meaningful **Consolidated Tape** can be created.

23.1 Equity Market Making

- **Equity Market Makers play a key role in providing reliable capital flows to support investors and issuers in less liquid securities, especially participants on SME Growth Markets.** Market Makers support less liquid securities typically SMEs) through capital commitment by voluntarily entering into agreements with Regulated Markets and MTFs to provide firm, two-way quotes, in size, in specified securities in the secondary market. This creates a robust secondary market structure for the trading of less liquid securities. It also supports the ability of issuers to raise funds by public offers, because it allows investors to be more confident that when they purchase securities, they know that there is a market in which they can be readily sold at a later date as necessary. This means that that the issuer incurs a reduced 'liquidity premium' (ie discount on the price of the offer) to cover the investors' risk of ease of exit or switching of investment. This directly contributes to a lower cost of capital for issuers and encourages early stage investors such as VCs to invest earlier in a company's lifecycle.

- **In the immediate term,** in relation to the impact on the ability of **equity market makers** to provide liquidity in less liquid securities, we make specific recommendations for amendments to MiFID and CSD-R level II measures (see box).

- **In the longer term**, a dedicated proportionate regime for market making in less liquid securities (i.e. on both regulated markets and SME Growth Markets) should be proposed to allow for a coherent horizontal revision of all relevant existing and planned regulatory impacts, including e.g. **Short Selling Regulation** (see Recital 26 and Article 17 - ability to provide capital commitment); **SFT** (ability to access a well functioning securities lending market to hedge positions effective; **CRD/CRR** prudential requirements (e.g. calibration of capital absorption rules to favour SMEs as long term investments); **FTT; MiFID; CSD-R).**

Equity Market Making - key immediate recommendations for MiFID and CSD-R level II

- **MiFID RTS 8: Deferred Publication should be extended for less liquid securities (typically SMEs).** The provision of risk capital in less liquid securities can be reliant on the ability of Market Makers to unwind risk positions with minimal market impact. Where a market maker takes on a larger sized position, sufficient time is needed time is needed to offset the position. Too short a time period before publication at end of day as proposed by ESMA will deter them from taking on further risk later in the day, leading to reduced provision of liquidity, wider spreads and higher costs to issuers and investors. The Commission wants CMU to "lower the cost of capital, especially for SMEs" and asks how "to support liquidity in vulnerable segments.

Proposed solution: *Table 5, Annexe 2 of RTS 8 should allow market maker trades in less liquids for deferral to at least the end of the day following the trading day (consistent with ESMA approach to illiquid derivatives which allows 48 hours for trades in illiquid derivatives/non-equities RTS9 Art 8(1)).*

- **MiFID RTS 15: Only the new category "investment firms engaged in algorithmic trading technique pursuing a market making strategy**" should be covered by the requirements, not trading venue members acting as market makers, providing market liquidity and support under established schemes.

  Proposed solution: *either*

  c) *(Preferred) this must be made clear in the RTS (please LSEG 's fully revised RTS 15 submitted to ESMA);* ***or***
  d) *If not, the RTS must explicitly allow for the two tiers of market making to avoid damaging consequences to existing market structure. To preserve existing market quality, LSEG must be able to continue with current market making schemes for non 'algo market makers' (A17(3)) requiring* ***90%*** *daily presence.*

- **CSDR: It should be noted that CSDR gives more flexible buying in terms for less liquid securities that reside on an SME Growth Market than less liquid Regulated Market securities.** For example, a cleared trade executed in a less liquid Regulated Market security will be subject to the same buying in terms as that of a liquid security. This anomaly could potentially deter the natural move in line with growth of a company from an SME Growth Market to a Regulated Market. It is important to recognise that a less liquid Regulated Market security may have the same liquidity profile of that of an SME Growth Market security.

  Proposed solutions:
  - *The cash penalty regime should distinguish between liquid and less liquid securities. A basic penalty rate should be applied to ensure that trading in less liquid securities (typically SMEs) is not discouraged.*
  - *The level of cash penalties also needs to be considered in terms of the amount of time the buy-in process can continue.*
  - *CSD-R must be recast to explicitly recognise that less liquid securities are traded on both regulated markets and SME Growth Markets.*

23.2 Consolidated Tape

- The Green Paper repeats the MiFID aims for a Consolidated post trade tape to ensure the quality, availability and timeliness of post-trade information. It also refers to the consequences should there be no market-led solution by the time of the ESMA review.

- LSEG agrees that there is a need for an authoritative feed of post trade data for EU securities, which should be comprised of trades reported and classified on a harmonised basis, both on all MiFID trading venues and OTC (including SI). We support the need for a harmonised, post-trade tape to allow investors to understand the quality of their execution. We support the organisation requirements of APAs/CTPs. Unfortunately, the MiFID requirements do not fully extend to OTC, so there will always be some extent to which OTC trading will not be accurately reflected in any Consolidated Tape.

- Moreover, whilst MiFID Recital 117 sets out the essential qualities of a Consolidated Tape (post trade data on all securities), neither the Level I text, nor the draft RTS or Technical Advice give any assistance in constructing a business case to any party who might consider establishing itself as a Consolidated Tape Provider, save that the supply of the data will be subject to the Reasonable Commercial Basis requirements to be defined by the Commission.

- **If the Commission is earnest in its desire to see a market-led Consolidated Tape established, we suggest that a key component of the CMU work is to develop, in conjunction with the market, a more detailed model of the Consolidated Tape - its uses, benefits and economics** for example, the user requirements; latency or granularity such that the industry would be able to develop a business model for introduction of a service in time for the ESMA review likely to have to start in late 2017.

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

- **We believe the existing rule book needs time to bed down, with the only remaining gap being the Recovery and Resolution regime for CCPs**. It is not a question of increasing the Single Rule Book but the consistent application of existing rules across all Member States, which we suggest is a matter of supervision and enforcement, not additional regulation.

- Please also see our response to Q25

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

- **More consistent application of existing Single Market rules can support both issuers and investors.** For example, ESMA's peer review of listing authorities' application of admission to trading requirements and the Prospectus Directive implementation across different Member States should help to avoid arbitrage and maintain consistent investor protection standards. MiFID has in large part addressed the coherence of trading venue and investment firm regulation, however effective and consistent supervision and regulatory enforcement by national competent authorities has not been sufficiently addressed (see box for 3 examples of inconsistent application of the single market rules).

- **ESMA should focus on driving through supervisory convergence across the EU.** To achieve this ESMA itself will need an enhanced ability to initiate and lead peer reviews across the EU and to ensure compliance by National Competent Authorities. It is the proper role of ESMA to be empowered to ensure effective and consistent supervision by National Competent Authorities across the EU. This is a completely distinct role from ESMA acting as a direct supervisor of firms themselves.

- **The Commission should produce a report on overlaps across EU legislation.** This would act as a reference for legislators and the industry when considering future regulatory initiatives as there is significant scope for convergence between existing EU legislation impacting the ability of SMEs to access equity markets. For example, transparency and disclosure requirements; approaches to liquidity across CSD-R and MiFID.

<u>**Inconsistent application of Single Market Rules - three case studies**</u>

1. **Marketing home state bias.** Measures are needed to help break down home state bias in the marketing of investment products, to contribute to an equity investment culture (see AIFMD case study). However, retail convergence is going to take longer to address than wholesale. This is not just a matter of disclosure and transparency (more information is not always conducive to better decision making). Rather, investor protection should focus on the valuable protections provided by the distribution end, such as through the appropriateness test under MiFID Article 25 (3).

2. **Access to Approved Reporting Mechanisms (ARMs).** Some competent authorities make it easier and cheaper to report to their own domestic reporting mechanisms, for example working closely with exchanges within their jurisdictions in the build of reporting mechanisms but not offering ARMs from other countries similar co-operation, leading to

an unlevel playing field and the perception of restrictive practices.

3. **AIFMD Passporting.** This Directive put in place an array of potential passporting regimes for the marketing of funds. For EU managers marketing EU funds, this is similar to the existing regime available for UCITS funds. However, for managers of non-EU fund, the object of harmonisation and a level playing field has not been reached because: (1) the directive provides for multiple Member states options and domestic exemptions, (2) there are important areas of legal uncertainty (i.e. regarding the types of products included in the scope as is the case of ETC that are treated differently in different Member States, etc. ; (3) marketing passports have been phased, therefore passporting is currently only available to EU managers of 'onshore' EU funds.

- A significant number of funds intended for marketing in the EU either have a non-EU nexus (from the manager or the fund) or are targeted towards retail investors, therefore more likely to use the existing UCITS regime rather than the fledgling AIFMD arrangements. Consequently, the predominant avenue for marketing of non-EU funds by EU managers under AIFMD is the National Private Placement Regime of each member state. While these share common themes driven by the AIFMD (predominantly the requirement to make a notification to each domestic national regulator in every EU jurisdiction in which the manager intends to market, as well as substantial associated reporting requirements in every jurisdiction notified), every domestic regulator has interpreted the notification requirements differently and often in a manner which can act to protect their own domestic fund management arrangements. For example, the UK only requires a form to be completed and submitted online to the FCA containing limited information about the relevant fund(s) being registered and its manager. There is no requirement for the FCA to approve the registration. In contrast, the German registration process comprises a detailed set of application forms to be supplied to the BaFin with extensive information on the fund and its manager. Additionally, the German rules also require the fund to have a depositary or custodian in place (not required by the AIFMD itself). In many jurisdictions it is also a requirement to obtain positive approval from the competent authority before active marketing can commence. Where additional, Member State-specific requirements and structures are necessary it makes the approval timeline very lengthy and means that the level playing field envisaged by AIFMD is not achieved in practice. This can lead to the situation where non-domestic marketing is effectively not an option.

- Below is a table which sets out the current situation is in terms of the ability for managers to market their funds in the different member states, the yellow box indicates how there is a lot of scope for the member states to interfere in the process and favour their own domestic arrangements.

	No marketing in member states	Marketing in member states via national private placement regimes	Marketing in member states with a passport
EU AIFM / EU AIF	• Authorisation required. • Full AIFMD requirements apply.	Not applicable	• Authorisation required. • Full AIFMD requirements apply.
EU AIFM / non-EU AIF	• Authorisation required. • Full AIFMD requirements apply (except depositary and annual report requirements). • Information exchange arrangements must be in place between the AIFM's regulator and the supervisory authorities of the country where the AIF is established.	• Authorisation required. • Full AIFMD requirements apply except the detailed depositary rules (although a depositary must still be appointed). • Information exchange arrangements must be in place between the AIFM's regulator and the supervisory authorities of the country where the AIF is established. • The AIF's jurisdiction must not be a Financial Action Task Force (FATF) Non Co-operative Country and Territory (NCCT). • Member states may impose stricter rules.	Not applicable

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

- **We agree with the Commission's view expressed in its 2011 consultation on legal certainty of securities holding and dispositions, that measures at EU level should not seek to harmonise the legal framework governing the question of whom an issuer has to recognise as the legal holder of its securities.** It is not only extremely difficult to harmonise the national laws of legal ownership of shares between Member States, but it is also unnecessary. A functional approach should suffice. For example, ensuring that information with respect to securities should be passed on the ultimate account holder, should they wish to receive it. In Italy, CSD participants are legally responsible for ensuring the security of the communication flow between the issuer and the ultimate investor. Moreover, market standards have led to the development of electronic formats to ensure an efficient process.

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

- **Market participants in Europe must optimise the use of collateral** and do so by targeting one single pool of collateral which allows real time substitution. Cross border solutions (e.g. Inter-operability between ICSDs and between domestic CSDs and ICSDs) will allow banks to have one single pool of collateral. This will help address the significant increase in the need for collateral to secure operations (e.g. operations with central banks, margin requirements, reverse repo transactions) following the financial crisis. We support the development of tools which allow collateral optimisation, such as triparty repo solutions, for which post-trade processing (e.g. collateral selection, payment and settlement, custody and management during the life of the transaction) is outsourced by the parties to a third-party agent. These have the advantage of allowing for real time substitutions and optimisation regarding the type of collateral delivered.

- **We support the ECB decision in May 2014 to remove the repatriation requirement, part of Correspondent Central Banking Model ("CCBM").** This decision made it easier for Eurosystem counterparties to use assets, held as collateral at their domestic CSD, for their Eurosystem credit operations. The removal of the repatriation requirement eliminated the need to move assets from the investor securities settlement system ("SSS") to the issuer SSS in CCBM operations. We would encourage all EU central banks to embrace this solution.

- **All EU resolution authorities should ensure that liabilities arising from cleared derivatives are exempt from bail in powers, under national regimes for the resolution of banks.** If there are inconsistencies, this could impact the enforceability of collateral and close-out netting arrangements by a CCP in a clearing member's default scenario, presenting significant challenges to the proper risk management operations of CCPs in running a 'matched book' and thereby undermining financial stability. For example:

    - A CCP may be unable to default a clearing member or liquidate a position with a clearing member simply because it is subject to bail-in provisions. This could place the CCP in a position where it holds an unmatched book (without access to the clearing member's default resources to make good any shortfall), thereby increasing systemic risk.
    - It could also impact the effectiveness of a CCP's default procedures (which are designed to recreate the matched-book in a default) if a CCP is required to deal with a contract on its 'bail-in' terms and could therefore increase risk contagion to other market participants.

- Furthermore it may result in market uncertainty if it was not clear that all liabilities owed to a CCP, including net sums due, were excluded from the scope of the bail-in power.

- **We support a Financial Collateral Harmonising Regulation as a long term aim, with convergence of existing practice under the Financial Collateral Directive as a medium term aim.** In order to improve legal enforceability of collateral (which supports effective risk management and efficient markets), we would support (in the long term) the introduction of a European legal framework for the harmonisation of rules regarding the methods allowing for effective acquisition of securities and collateral interests therein and the regime regarding good faith acquisition, building on the Financial Collateral and Settlement Finality Directives. In this connection it has been observed that even netting-friendly jurisdictions may have inconsistent laws regarding:

  (i) the scope of eligible parties allowed to use close-out netting: for instance, insurance companies or special purpose vehicles used by banks in the context of securitisation might or might not be netting-eligible, depending on the jurisdiction;
  (ii) the eligible types of contracts: jurisdictions differ, for instance, in their assessment of whether physically settled derivatives should be netting-eligible; and
  (iii) the extent to which close-out netting is compatible with the *pari passu* principle: for instance, the applicable regime regarding knowledge by the solvent party of the approaching insolvency of the counterparty differs across different jurisdictions.

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

- **In the long term, fully harmonised rules around legal certainty are important to maximize safety and efficiency when settling across borders in T2S.** However the absence of a comprehensive legislative conflict-of-law solution at the time of the T2S launch does not undermine legal certainty in T2S, as there has been much progress over the past decade in securities settlement in the euro area, although it remains fragmented, inefficient and not very customer-friendly. This is not just a problem for smaller businesses, for which adapting to different conditions in the Member States often entails high costs, but also for the integration and functioning of the single market as a whole. The introduction of T2S will NOT *per se* remove the legal risks associated with the transfer and holding of securities across jurisdictions. In fact, T2S will only provide the technical and operational environment for the seamless delivery-versus-payment of securities within and across CSDs. The scope of future harmonisation should not be limited to the CSDs but extend to other financial institutions involved in the issuance, trade and post-trade of securities.

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

- **In the long term, a comprehensive revision of certain aspects of insolvency law may be required.** Persistent legal issues relating to securities holding and transfers are strongly connected to domestic insolvency law and property law. Both are traditionally applied on a mandatory basis. Therefore, market participants are unable to simply choose one jurisdiction's law, as they might to regulate their contractual relationships, and have the entire situation governed by it. Many investors are unaware of, and may sometimes be sceptical about the order of priority on insolvency in other member states. This may deter many of them from cross-border investment activity. Cross-jurisdictional legal certainty heavily depends on the compatibility of these mandatory domestic laws. We support the analysis of the AFME letter to the European Commission on 7th April 2015

- **In the medium term, CMU can build on the two Giovannini reports by taking a functional approach to harmonisation, rather than addressing fundamental legal concepts.** This would allow member states to opt-in to changing technical arrangements without changing laws or taxation arrangements. We believe there is scope among the remaining "Giovannini Barriers" defined by the Legal Certainty Group to be addressed in this way (e.g. the methods for acquisition and disposal; the minimum content of the acquired position; effectiveness and reversal; the protection of the acquirer; priority issues; the integrity of the number of securities; instructions; and, the possibility of attachments.)

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

- **State Aid.** It is clear that a key component of such barriers is the way that some Member States may avail themselves of the state aid rules in order to avoid granting fiscal incentives for appropriate investment vehicles. We support comments by the Competition Commissioner that member states ought to be taking full advantage of the revised guidelines on risk capital and state aid rules; too often national governments are minded to use EU state aid rules as blanket excuse for inaction, particularly on tax incentives for investment.

- **Steps must be taken to address the fiscal bias against equity in order to encourage an equity culture.** Currently, equity is taxed as many as four times in some member states (dividend tax, corporation tax, capital gains tax, financial transaction tax); in contrast, debt is tax-deductible. This has contributed to Europe's over-reliance on bank debt as a source of funding.

- **However restricting the tax deductibility of debt is not the answer, as this will lead to a higher cost of capital**. Instead the Commission should take forward an extensive investigation into the impact of the fiscal bias against equity against the cost of capital, especially for SMEs. Proposals for an FTT should be dropped altogether, or at the very least ensure that appropriate exemptions are provided for both SME issues and investors and those that support their ability to raise non-bank capital (e.g. market makers.)

- **Recent evidence from the UK provides strong evidence in favour of reducing the taxation of equity.** Since the abolition of the UKs own FTT, Stamp Duty, for companies quoted on the UK's leading market for SMEs, AIM, there has been the largest issuance since the financial crisis (€8 billion in new and further issuance in 2014 alone). Taken together with the inclusion of AIM companies in tax-advantaged 'ISA' accounts, there has been a significant inflow of retail investment into SMEs (€6 billion in one year), providing valuable liquidity and helping to give individual citizens a stake in the future growth of some of Europe's most promising and exciting growing companies.

- **Evidence suggests a negative impact of the FTT in France.** A Tabb Group[8] report found that France's market share of European equities fell by 23.4% to 13.11% from 17.12% in its first year of implementation.

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

- **There is great potential in the role of technology to contribute to CMU, so regulators should take a supportive and flexible approach to new applications**. The relationships and exchange of information between listed companies and investors can be enhanced by increased use of accessible digital technologies. For example, the ELITE programme uses a unique digital platform to enable companies to meet and deepen relationships with investors as part of their investor relations activity.

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

- **Ambition.** We appreciate that the Commission has stimulated a wide ranging debate deliberately in order to encourage creative thinking. And we support an evidence-based approach. However, the Commission should weigh carefully the downside of insufficient

[8] Tabb Group hyperlink

ambition. Seeking to put in place only the building blocks by 2019 is likely to lead to a low level of achievement and to disappoint.

- **Equity and debt solutions have separate considerations (as well as many in common e.g. distribution).** This should be made absolutely clear in the action plan because a more structured plan will ensure CMU is understood, coherent and will make it easier to achieve. For example, for equity, governance standards are important but insolvency law is not.

- **The most important goal is to increase market depth and liquidity in all countries and investment flows from outside the EU, not necessarily insisting that success is only defined by the level of internal cross-border investment.**

- **IPO Task Force.** LSEG strongly recommends that the Commission gives due regard to IPO Task Force report, chaired by Philippe de Backer MEP.

- **Targets**. The Green Paper points out that 80% of EU business finance comes from banks and 20% non-banks, and says that therefore the EU is over dependent on the banks. A target should be set to reduce the 80% figure, perhaps linked to the Enterprise Finance index[9]. At this stage, an ambitious target would be 50/50, potentially to be achieved over a 20 year period given the experience of the US during the financial market deregulations since 1980 (during which time the share of non-bank private financial assets as a % of GDP grew from around 60% to closer to over 80%) .[10]

- **EU 28.** CMU should include all 28 EU Member States. It is a project for the Single Market not the Eurozone.

[9] The Enterprise Finance Index provides data and information on access to finance for SMEs across the EU.
[10] MGI_Global_capital_markets_Entering_a_new_era_gcm_sixth_annual_full_report (p8)

Appendix A - Indicative list of potential EEA SME Growth Markets

The table lists 19 markets that are currently operating across the EEA which potentially could fall under the SME Growth Markets regime. They are home to over **3000** companies with a combined market capitalisation of over **€200 billion**. Please note this is not a complete list (not would all of these markets necessarily apply for SME Growth Market status) but is provided as contextual background to this paper.

Member State	Growth market	Market Operator	Companies*	Mkt Cap (€ bn)
Austria	Dritter Markt	CEESEG – Vienna	19	2
Cyprus	Emerging Companies Cyprus	Cyprus Stock Exchange	21	0.7
France, Netherlands, Belgium	Alternext	Euronext	194	10
France & Belgium	Marche Libre	Euronext	324	TBC
Germany	Entry Standard	Deutsche Borse	166	37.9
Greece	The Alternative Market (EN.A)	ATHEX	14	0.1
Hungary	BETa	CEESEG - Budapest	23	TBC
Ireland	Enterprise Securities Market	Irish Stock Exchange	27	56.2
Italy	AIM Italia – Mercato Alternativo	Borsa Italiana (LSEG)	62	2.3
Italy	ExtraMOT PRO (non-equity)	Borsa Italiana (LSEG)	90	5 (total outstanding debt)
Luxembourg	Euro MTF	Luxembourg SE	159	0.7
Norway (EEA)	Oslo Axess	Oslo Børs	33	1.9
Nordic States	First North	Nasdaq OMX	165	5.9
Poland	New Connect	Warsaw Stock Exchange	428	2.3
Slovakia	Bratislava Free Market	Bratislava Stock Exchange	66	TBC
Slovenia	Entry Market	Ljubljana Stock Exchange	33	0.4
Spain	MAB Expansión	Bolsa de Madrid	26	1.6
UK	AIM	London Stock Exchange (LSEG)	1088	98.5
UK	ISDX	ICAP	77	2.8

*March 2015, sources: FESE, LSEG, Euronext, Nasdaq OMX, ICAP, Ljubljana Stock Exchange, Warsaw Stock Exchange