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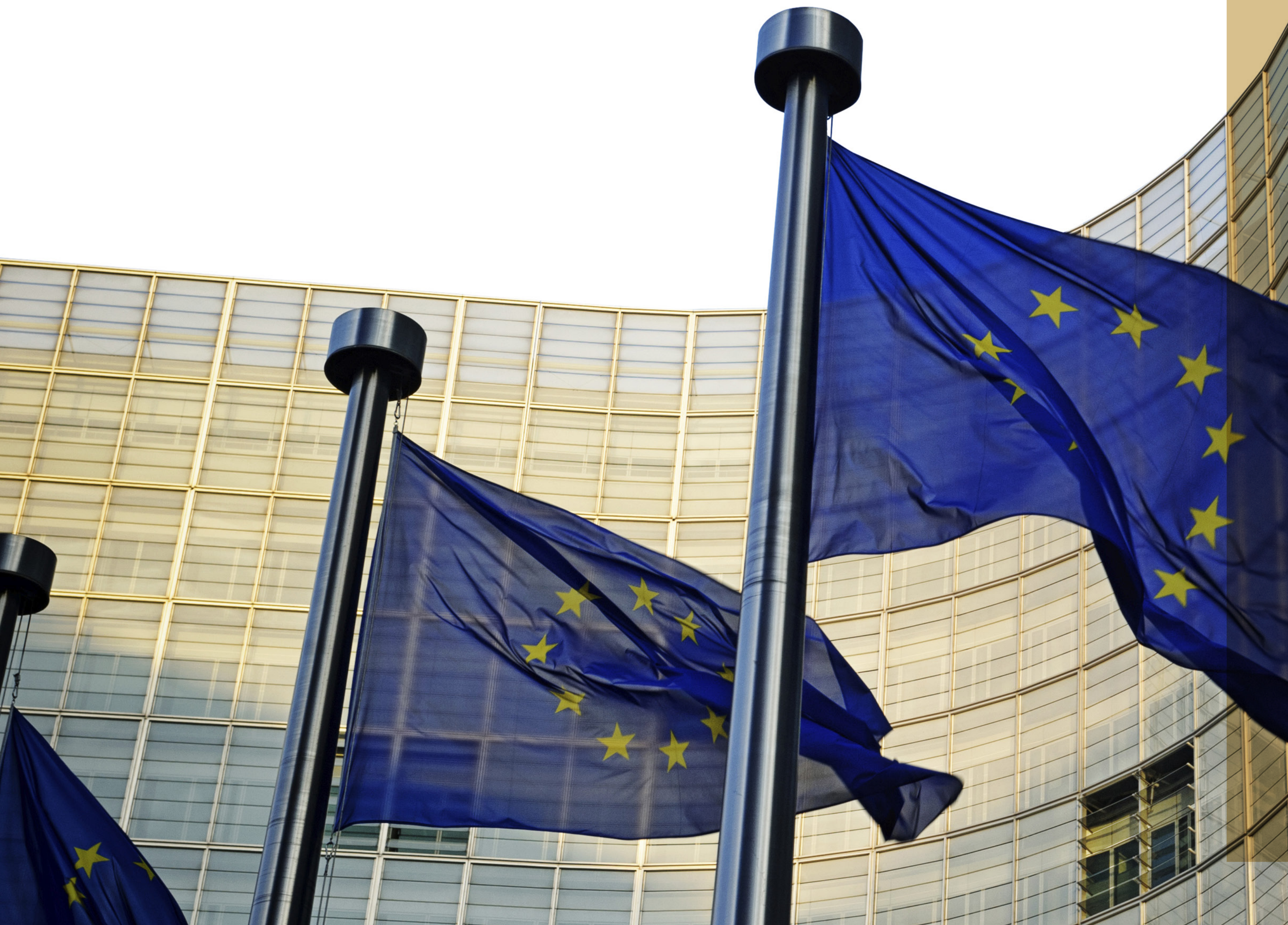
CLIFFORD CHANCE: RESPONSE TO THE EUROPEAN COMMISSION'S PLANS FOR A CAPITAL MARKETS UNION



OUR RESPONSE TO THE EUROPEAN COMMISSION'S PLANS FOR A CAPITAL MARKETS UNION

The European Commission has unveiled its plan to boost funding and growth across Europe through the creation of a Capital Markets Union – a single market for capital across the 28 EU member states. Earlier this year the Commission issued its Green Paper on *Building a Capital Markets Union* to stimulate debate on removing the many obstacles to deep and integrated capital markets. We have produced this paper outlining our response to the Green Paper and highlighting issues for the Commission to consider in its development of this initiative.

Priorities for early action

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

In order not to dissipate efforts, we think it is important not to have too many priority areas. Focusing on the five areas identified for short-term action should reap rewards; in particular, re-starting the securitisation market and supporting the development of a pan-European private placement market would significantly help to develop and diversify the supply of funding.

One practical step that could be taken in the short term is to review the effect of existing regulation. Consideration should be given to repealing certain provisions enacted as part of the wave of regulation - indeed, some might say overregulation - following the financial crisis and, more generally, the impact of increased regulatory capital requirements which have resulted in a significant reduction in the supply of funding to the real economy. We elaborate further on this in response to question 21.

In addition, consideration should be given to removing pre-crisis obstacles, such as the restriction of the loan market to lending banks, which prohibits new financiers from funding SMEs; overly tight consumer credit lending restrictions, which potentially inhibit "crowdsourcing" of start-up capital; and the absence of a specific exemption for sub-PD offerings, which leave them vulnerable to national legislative problems.

As some of the biggest obstacles to the free flow of capital are on the "buy-side", consideration should be given to identifying and removing the barriers faced by investment funds in their cross-border operations, thereby complementing banks by providing an alternative source of funding for economic growth. We elaborate further on these in our answers to questions 15 and 16.

Another area that might be considered in the medium to long term is the creation of a pan European listing platform or stock exchange. Listing still takes place at the national level, which is a somewhat artificial barrier in today's capital markets. Having a pan-European listing across exchanges (if creating a pan-European model did not gain the support of member states at national level) would be a measure which could encourage cross-border capital flows within Europe.

In the longer term, there are other significant obstacles that would need to be overcome in order to establish a true capital markets union, for example the possible harmonization of tax regimes and pension regulations, but achieving these would inevitably be problematic and it may be imprudent to pursue these and lose sight of what is achievable.

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?

Due to the costs involved, it is unlikely to be worthwhile for individual non-bank finance providers to establish bespoke credit analysis capabilities for SMEs. We therefore believe, although we acknowledge the diversity of SMEs and that "one size might not fit all", that consideration should be given to ways of making SME credit information more accessible to a wider range of finance providers and standardized (as much as is feasible) so that it is more easily understood. For example:

- By promoting IFRS for SMEs as a separate standard for selected financial information
- Confirmation of compliance with a set of governance standards, including anti-money laundering, anti-bribery, anti-corruption policies and procedures, being in place (effectively establishing a 'kitemark for compliance'). Such external validation could reduce the amount of disclosure needed on such matters in the disclosure document
- Consideration should be given to streamlining "Know Your Customer" procedures, as these can be cumbersome and unduly slow.

These measures would be helpful, inter alia, in supporting 'direct lending' by funds and asset managers.

Finally, a key issue that will need to be addressed in the context of SME credit information is data protection, as many SMEs are typically reluctant to disclose confidential information about their business.

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

European Long-term Investment Funds, or ELTIFs, are new products, set to launch later in 2015, so it is too early to predict with certainty what their take-up will be. However, given the long-term nature of ELTIFs and the lack of an established track record, it may be that some form of incentive is needed to encourage take-up, or that certain issues that may act as disincentives for managers and investors are addressed.

Support could include:

- Ensuring that the technical standards to be published by ESMA complement the Level 1 text to provide certainty to the market on how the new regime will operate

- Encouraging member states not to introduce unfavourable tax treatment for investment in ELTIFs (see discussion of tax incentives below)
- Keeping the regulatory burden to an absolute minimum

  As the Level 2 process unfolds, it will be important to ensure that the ELTIF regime does not give rise to a whole separate set of onerous regulatory requirements, as this would act as a major disincentive.

  It is important to bear in mind that a huge swathe of the European asset management industry is emerging from AIFMD implementation and so in the early years of compliance with what is the biggest ever change to the way in which the European asset management industry is regulated. To encourage alternatives managers, particularly those in the private equity/infrastructure fund space, to consider the ELTIFs regime, it will be important to keep any additional regulatory burden to an absolute minimum, particularly if the fees earned from retail investors are expected to be relatively small.

  Key to this will be:

  - ensuring no conflict between the regime governing ELTIFs and AIFMD requirements
  - ensuring no duplication in relation to regulatory filing/notification requirements for AIFMs wishing to manage an ELTIF
  - streamlining the marketing passport procedure, particularly in the context of marketing to retail investors
  - imposing realistic liquidity requirements
  - ensuring absolute flexibility around the types of vehicle the managers can use so they can select the optimal tax and regulatory structure for their investors

  For more mainstream asset managers, for example those managing an alternatives platform via an AIFM as well as a UCITS or other mutual fund platform, it will still be important to keep the regulatory burden to a minimum, even though these managers will be more familiar with operating retail structures.

  Keeping the regulatory burden associated with ELTIFs to a minimum should prevent regulatory costs being passed on to investors by way of higher fees. For institutional investors, for example, the level of fees will be key, as they are unlikely to want to pay higher fees than they would were they to invest through a PE infrastructure or RE structure.

- Consider whether investor incentives are necessary

Introducing some form of incentive (e.g. tax incentives) for investors may encourage take-up of ELTIFs, particularly as they are a new product with no established track record. For example, retail investors might be reluctant to lock up capital for a long period of time. Some form of tax incentive might encourage them to do so.

- Review regulatory capital treatment of ELTIFs

Attention should be given to the regulatory capital treatment of ELTIFs, as diverse regulatory capital charges will act as a disincentive.

- Consider whether specific aspects of the ELTIFs regulation are discouraging take-up

The minimum investment level for retail investors (EUR 10,000) may act as a barrier.

There is potential for tension between setting the right minimum subscription amount and ensuring retail investors do not lock up their capital for longer than they are financially able to bear.

- Ensure ELTIFs are developed as part of a coherent policy on long-term investment

ELTIFs are part of a wider policy agenda to encourage long-term investment in Europe. It is important that the ELTIF regime is developed in a coherent manner alongside other policy initiatives and with other sectors of the market.

- Assess barriers to ELTIFs deploying capital cross-border

ELTIFs are intended to increase the amount of non-bank finance available for companies and projects in Europe and, to be most effective, the funds should be deployed across borders. Barriers (e.g., in the form of licensing requirements and withholding taxes) exist in many countries and may inhibit cross-border lending by ELTIFs. In addition, enforcing security could be cumbersome for ELTIFs, as we discuss further in response to question 29 below. Addressing such barriers could increase the up-take of ELTIFs.

- Information on investments

We note the emphasis in the Green Paper on providing information for investors, e.g. on SME credit information and the infrastructure project "pipeline". We agree that improving information and transparency could increase their attractiveness to investors, including ELTIFs.

In addition to the support outlined above, the ELTIF regulation may require review. In its current form, the ELTIF Regulation applies multiple levels of incompatible regulation. The EU has two models of retail fund regulation – either to apply restrictions at the fund level and permit funds thus governed to be freely sold retail (the "old UCITS" model) or regulation at the point of sale (the "old MiFID" model). The ELTIF Regulation combines both, in that it imposes restrictions both at the sale level and at the fund level. It also introduces a whole new concept of suitability to be applied by fund managers which works contrary to the way the industry operates. To make the new regime more workable, the restrictions on sales and on investment powers should be removed; the requirement should be that if the fund (a) produces a KIID, (b) is subject to the transparency requirements already set out in the document, (c) the manager or the distributor has satisfied themselves that the product is fit to be sold retail, and (d) that fund units may only be sold in the EU as complex products under MiFID 2, it should be capable of EU-wide retail distribution.

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?

We endorse the response to Q4 submitted by the ICMA on 30 April 2015. In our view the natural evolution of private placement markets in Europe will be facilitated largely by market led initiatives, which should be supported by the European Commission. There are several current initiatives which will increase market awareness, standardisation of documentation (which has been an issue) and establishment of best practice, thereby developing the EU as an attractive location for private placement deals. For example:

- The Loan Market Association has developed standard-form private placement templates (in both loan and bond format). The use of these will enable participants in the market to establish private placements as a recognisable product.

- The development of the Pan-European Private Placement Joint Committee, which includes the International Capital Market Association (ICMA) and the Association for Financial Markets in Europe (AFME).
- The Pan-European Private Placement (PEPP) Joint Committee published the Pan European Corporate Private Placement Market Guide in February of this year. The Guide sets out a voluntary framework for common market standards and best practices for the development of the market.

Through these and other market-led measures, we believe that the market will naturally develop. That said, the PEPP Joint Committee would welcome the support of the European Commission and EU member states in promoting the standards set out in the Guide. While there is no need for additional regulation in this area, there does need to be a regulatory level playing field and we would highlight the following areas to the European Commission for action:

Market led initiatives

Market led initiatives increase market awareness, standardisation and establishment of best practice, hereby developing the EU as an attractive location for private placement deals. The Pan – European Private Placement working group includes the European Private Placement Association (EUPPA) of which Clifford Chance is a founder member.

Capital weighting treatment and Solvency II

There is uncertainty in the market about the capital treatment of European private placement bonds arising from differences between regulatory regimes.

For example, under the US regime the National Association of Insurance Commissioners (NAIC) provides a scoring of private placement bonds that determines their regulatory capital treatment. This provides certainty and also results in US deals being priced cheaper than equivalent deals in Europe as the rating is usually lower than the capital charges which can be achieved under Solvency II for European investors, where there is no rating regime.

There are also differences between domestic European regulatory approaches. For example, French investors can apply an internal rating model to bracket credits and reduce the capital charge. By contrast, in the Netherlands, investors must put private placement assets into a "non-rated bucket" which carries a higher capital charge.

Additionally, the ICMA has estimated that European institutional investors may face higher capital charges investing in such assets under Solvency II than banks investing under Basel III rules.

These discrepancies are a barrier to growth. Providing some clarity for investors and creating a level playing field across the regulatory and fiscal landscape would bring more certainty and could lead to increased investments in European private placement bonds. In particular, bringing more clarity may attract smaller investors to the market. However, further analysis would be needed on appropriate adjustments to Solvency II capital weightings to avoid disincentives for investment in private placement bonds and long-term assets in general. The benefits of creating an NAIC-like structure in Europe would need to be considered carefully, as introducing the additional burden of having to publish a rating may not be attractive to issuers.

Rating credit and scoring info

The lack of access to performance and valuation data on the issuers in the market (typically mid-sized, rather than small businesses) makes it difficult for potential investors to evaluate these companies. Improving the availability of such information would be beneficial; however, this needs to be carefully considered, as creating a burdensome reporting regime may have the unintended consequence of discouraging issuers (see comments in Q2). As mentioned elsewhere, rating agency regulation should be restructured to promote an efficient, transparent and competitive private ratings sector, since the existence of such a sector is essential for the proper functioning of a capital market. Consideration could be given as to whether banks and other lenders could provide risk assessment indicators for particular borrowers which would not be classed as ratings and would fall outside the regulatory regime.

Tax issues

The proposed EU financial transactions tax (the "FTT") and the imposition of withholding taxes on interest are of particular relevance to the development of private placement markets (see response to question 30). In the context of private placements in particular, we make the following observations:

In our experience, private placement lenders wish to benefit from the flexibility to invest by way of either loans or notes. In many cases the distinction between loans and notes is simply one of form, and the parties choose whichever they are most comfortable with. In other cases, there are legal or commercial factors which necessitate a loan or a note. Our key concern in the context of the private placement markets in particular is that if the FTT is introduced and applies to notes but not to loans, this could impede the development of the private placement market (or at the very least, limit the flexibility of the parties to choose the form of instrument which they are comfortable with).

Many EU member states and non-EU countries (such as the United States, Ireland, France, Germany, The Netherlands, Luxembourg, Sweden and Denmark) currently do not impose withholding tax on typical private placement interest and the UK is introducing a new exemption from UK withholding taxes on privately placed debt. The abolition of withholding tax on interest on private placements would therefore be important to ensure that all EU jurisdictions are competitive in the private placement market and that companies in these jurisdictions can raise private placement finance.

Non-bank lending and institutional investors

As discussed further in our response to Q16 below, there are a number of barriers that exist to non-bank lending. PEPPs can be documented in both bond and loan format and can also be acquired by institutional investors through fund structures. The general points made in response to Q16 therefore also apply here.

Measures to develop and integrate capital markets – improving access to finance

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

This response focuses on access to funding for smaller and mid-cap borrowers (SMEs). Whilst "capital markets" is taken by some in the market to refer to any non-bank funding (including "shadow banking"), this response is limited to capital markets in the traditionally accepted sense.

For SMEs, the European Commission might consider:

- **Requiring removal of any impediments under national legislation:** Some local (national) laws provide that certain types of companies cannot offer debt securities to the public (often with an unclear description of what that might be or imposing a limited number of investors). Under the UK Companies Act 2006, for example, private companies cannot offer securities to the public and need to convert to a "PLC" (or other type of company) before doing so. Whilst this increases the capitalisation of companies, it does not remove investor risk.
- **Diversifying or reducing the risk of investing in SMEs:** Encouraging investment through diversifying or reducing risk might encourage retail investment. This might include greater reliance on "indirect funding", some form of credit support or insurance, or creating a special (plain vanilla) "SME market", discussed further in the bullet points below:
    - *Improving access to indirect funding:* Rather than direct funding, a solution for SMEs might be indirect funding – that is, by improving indirect access to the EEA capital markets. This might include, for example, efforts to develop an SME securitisation market (with appropriate diversification of underlying loans across tranches) or the introduction of specialised SME funds (UCITS). This would help to diversify investor risk and may make "retail" investors more likely to invest in such companies.
    - *Providing limited credit support and/or default insurance:* Investments, necessarily, involve some element of risk. Indeed, even where individuals place money on deposit with a bank, they accept a level of risk of losing their deposit in the event that the bank has financial difficulties. A portion of the deposit (in the UK this is currently Pounds Sterling 85,000) will, however, be protected. A similar protection scheme could be instituted for SME bonds where a certain amount / percentage of the issuance is protected. This could be created by a special "SME" platform. It is right that there should be some risk - in fact, the investors receive a higher return to compensate them for a perceived higher risk. However, providing for a limited form of protection (for example, through third-party insurance or even through government or EU protection) might encourage investment by individuals and also allow SMEs to avail themselves of cheaper funding.
    - *A special SME platform:* Creating a special platform on which to invest in plain vanilla bonds only.
    - *Credit rating or credit scoring:* Creating a simple form of credit rating or credit scoring in relation to SMEs might assist – possibly combined with some or all of the suggestions in the bullet points above (see also comments in Q. 4 above).

- **Reducing costs for issuers by simplifying offering documentation and prospectus disclosure:** See also our more general response to Q. 6. In relation to SMEs, one point to flag is that, as highlighted in the Prospectus Directive Consultation Paper, few issuers have taken advantage of the reduced prospectus disclosure regime (described as the "proportionate disclosure regime") under the Prospectus Directive which was introduced in 2012. There might be a mix of reasons for this. However, at the same time, in the absence of the protection measures mentioned above, SMEs are, by their very nature, more of an unknown quantity and also, possibly a riskier investment proposition than larger, frequent issuers. Consequently, investors are more likely to want more disclosure, rather than reduced disclosure, on the company. The idea of having a special, reduced level of disclosure for SMEs is, therefore, not proposed as a solution. Any moves towards standardisation (discussed in Q. 6) would also assist SMEs.

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

We have set out our views below, but, as a general comment, we would also endorse the response on this question submitted by the ICMA on 30 April 2015.

Market liquidity can be described as the ability to trade one asset for another, at a level close to the prevailing market price. Liquidity can be difficult to assess, but, compared to share markets, corporate bond markets are "illiquid". There are various reasons for this, such as:

- Most bonds trade fairly infrequently – possibly not for weeks or months. Some bonds are purchased on the issue date and held until maturity. There may, therefore, not always be a willing seller and a willing buyer in the same bond at the same time.
- There is a lack of "homogeneity" in the corporate bond markets. The market comprises not only a vast range of issuers (from large banks (who might issue frequently) to SMEs (who might rarely, if ever, access the markets)), but, also, different types of products (with different maturities, coupons, issue sizes, covenants, and characteristics related to the seniority and security of the debt, as well as different ratings). This not only impacts liquidity, but also militates against standardisation (see below).
- Liquidity in corporate bonds markets is "dwindling" due to the unwillingness of investment banks to act as "market-makers", ready to offer to buy or sell securities at a particular market price. According to Bank of England sources, global investment banks reduced their trading inventories by almost 25% in the five years after the 2008 crisis. This is, in part, a reaction to losses encountered in the 2008 crisis, but it is also a direct result of regulatory reforms impacting bank capital requirements and proprietary trading.

Given these constraints, it is unlikely that a market as liquid as equity markets (in the sense of "an executable price, at any time and at short notice") could be achieved. There could, though, be improvements. The points below outline some areas which might help to promote liquidity.

Some would benefit from supportive regulatory measures:

- **Market-making:** Whilst noting that there is not likely to be the same demand for bond trading as there is for equity trading, market-making activities for bonds could be encouraged via regulation.
- **Facilitating "taps" to increase issue size:** In a recent presentation, Dame Clara Furse, an external member of the Financial Policy Committee of the Bank of England (in her speech "Liquidity Matters" on 1 February 2015) stressed that, even without market-making, in theory, a large and liquid market for securities could exist. This could be facilitated by trading platforms (see below in Q. 23), but it requires numerous, fungible, regularly traded securities. For corporate bonds, encouraging larger sizes of issues might assist: large-sized issues tend to more liquid than smaller issues. A regulatory change in relation to the Prospectus Directive, such as removing some of the onerous retail disclosure requirements and permitting issuers to incorporate certain future information by reference into prospectuses, both for issues on EEA regulated markets and MTFs, would facilitate "tap" issues (that is, subsequent, additional issues intended to be fungible with the original issue), thus increasing issue sizes and, hence, liquidity. See further the suggestions made in the ICMA on 1 May 2015 response to the Prospectus Directive consultation. Alternatively, if the regulatory framework were to envisage issuances with flexible principal amounts, this would improve liquidity by facilitating swifter tap issues. Provided that issues were of a principal amount that was 'at least' above a benchmark level of liquidity at all times, and 'up to' a maximum level of authorised debt incurrence, it would be possible to enable corporate issuers greater flexibility in Eurobond issuance. This would enable the issuer to issue more, buy back, and re-issue within a range over time with much greater ease, which would promote liquidity. This could be achieved relatively easily within the existing structure of Medium Term Note (MTN) programmes with up-to-date disclosure (at the time of any issuance/re-issuance). It would also facilitate greater reverse enquiry issuance of corporate bonds.
- **Adjusting offering exemptions to facilitate secondary offers:** Removing the requirement for a prospectus for secondary offers would also improve secondary trading (see for example the suggestions in the ICMA response dated 1 May 2015 on the European Commission Prospectus Directive Consultation). Providing for secondary market offer exemptions where a separate prospectus would not be required for secondary market offers would assist.
- **Removing tax impediments or other disincentives to cross-border sales:** This is discussed elsewhere in this response (for example in the context of withholding tax and the proposed Financial Transaction tax (FTT)).
- **Improving access to and "fluidity" of collateral, including cross-border flow of collateral:** This is discussed elsewhere in this response.
- **Increasing cost-effective access to markets and market transparency**: Measures which encourage a diverse range of

participants (including retail investors) should be considered, alongside high quality research and analysis, suitable advice (from MiFID advisers) and a central filing repository for Europe, enabling better access to information – although, as highlighted in the ICMA response on this Q. 6, transparency is not the same as liquidity.

- **Standardisation**: Standardisation can mean many things:
  - Standardisation in the sense of aligning issue dates, maturity dates coupons, etc. (such as occurs in the US, where dates tend to be aligned to US Treasuries) is not encouraged – and might increase market risk;
  - There might be a benefit, though, in developing more standardised documentation, although the diversity and lack of "homogeneity" in the corporate bond markets (described above) can mean that standardisation of documentation must be limited to specific types of product. Some market attempts in the past to achieve uniformity, e.g., the adoption of a "one-size-fits-all" standard Subscription Agreement, have been unsuccessful. There has, though, been success in the promulgation of "standard" or "pro forma" documentation for certain particular products, leading to market standard documentation and reduced costs (thus encouraging issuance). In the bond markets, these include industry standard pro forma Final Terms for MTN programmes and pro forma documentation in the commercial paper (CP) market. The discussion on Green Bond Principles (GBP) and the Private Placement documentation initiatives (discussed elsewhere in this response) also highlight the benefits of "market-led" initiatives towards standardisation. A key feature is that they are "recommendations" and are not mandatory;
  - Where standardisation of documentation derives from regulation (such as in the case of the "direct effect" EU Prospectus Directive Regulation which is uniformly applicable across the EU (and EEA) and which governs what needs to be disclosed in a prospectus), however, there needs to remain some flexibility to adapt to market developments. In the case of disclosure under the Prospectus Directive Regulation disclosure "Annexes", for example, many competent authorities have felt that "their hands were tied" and that they had to adhere to certain stances mandated under the legislation, even where the view across ESMA was that such provisions were unhelpful. This leads to delays in issuance and cost – potentially impacting issuance size and fungibility.

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

ESG investment is a nascent but growing market. The most marked recent growth has come in the form of "green bonds" and the Climate Bond Initiative is predicting issuance of up to USD100bn green bonds in 2015. All market participants agree that in order for the market to grow further development in transparency and independent verification is needed. In order to address these areas, and as referred to in the question, the market has developed its own set of guidelines – the Green Bond Principles – and a revised version of these was published in March 2015. The revised principles also go some way towards improved standardisation by setting out a broad definition of green bonds and identifying four key principles that any green bond must satisfy.

The principles are entirely voluntary. Our understanding is that the majority of market participants feel voluntary compliance with the principles is the best way to support this developing area, as being too prescriptive could impose unduly high barriers to entry. The aim is to encourage as many issuers and investors to the market as possible. We agree with this proposition.

The current establishment of Green Bond Principles has been an excellent 'jump-start' to enable a market-driven solution by focusing on improving information in, and therefore efficiency of, the market. A competitive market for the delivery of third party audits of green objectives has already developed, as has a Green index. Provided that the Green index only permits bonds that are verified as being towards Green objectives, and information is freely available, this should be sufficient to enable the development of the Green bond market.

At this stage in the market development and given the current success of green bonds it would seem prudent to support the market solution and the status quo - at least in the short term. It is however worth noting that at the moment the Green Bond Principles do not cover the broader category of ESG investment. To the extent any market developments in this area emerge our position is that these should also be supported to facilitate organic growth in the market but that further involvement of the EU at this stage would be premature.

However, if the ESG market development slowed in the coming years or needed further stimulus preferential capital treatment or tax incentives could be considered. Our view is that these would be longer term options if the market led solutions ceased to be as effective as they currently seem to be.

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?

There may potentially be merit in developing some form of limited common accounting standard across the EU. Accounting and financial reporting requirements for SMEs in the EU have been significantly reduced following amendments to the Accounting Directive, and attempting to raise funds based on existing financial statement requirements is likely to be unacceptable to investors for many SMEs.

SMEs across the EU currently adopt a variety of different national standards, some IFRS, and some under the IFRS standard for SMEs. There are many benefits for organisations using the IFRS standard for SMEs, such as the ability to seek out international financing and, while full IFRS is too expensive and onerous to implement for small organisations, those which adopt IFRS for SMEs may find the transition to full IFRS easier as their business grows. However, in many countries, separate accounts for tax purposes are also required, which do not follow IFRS. Also, each EU country is potentially doing its own thing – for example, the UK recently updated UK GAAP with FRS 102 for, inter alia, SMEs. Accordingly, there are currently significant issues with comparability of SME accounts across the EU.

The experience of IFRS has generally been positive in providing adequate and comparable financial information for investors in the major capital markets, and it might be the case that some form of standardised accounting for SMEs would yield benefits in terms of access to capital and lowering the cost of capital. There is certainly a case for some additional and standardised approaches and information.

The additional compliance burden on SMEs should be kept to a minimum and detailed cost/benefit research of any changes would be required. Any new requirements would need to be compatible with IFRS, as the development of specific EU requirements would risk further fragmentation. The European Commission's consultation on IFRS for SMEs in 2010 highlighted certain requirements which are incompatible with the Accounting Directives and the European Commission should look at amending the EU Accounting Directives to address this. Any industry specific reporting requirements would need to be borne in mind and national standard setters would need to be engaged with the initiative, to avoid SMEs having to prepare multiple sets of financial statements.

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?
Yes. There are barriers to the development of appropriately regulated crowdfunding or peer-to-peer-lending on a cross-border basis, largely because such organizations are in their infancy and such regulations as have been introduced (e.g. in the UK, France and Italy) focus on national, rather than European or international, requirements. As a result, the regulatory requirements diverge from one country to the next, making it difficult for platforms to raise or lend funds across borders. At this stage, it may be premature to introduce a pan-European regulatory framework for crowdfunding, as the industry is still developing and is responding to different cultural, linguistic and legal frameworks. However, as we move forward, better co-ordination of crowdfunding regulations across borders (albeit not necessarily <u>new</u> regulations), both across the EU and internationally, would assist cross-border investment and deployment of capital.

Measures to develop and integrate capital markets – developing and diversifying the supply of funding

10. What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?
With regard to long-term projects and infrastructure funding, we think the European Commission should focus on the following areas, which were identified by investors in a recent BCG/AFME report, "Bridging the Gap":
(i) the reduction of political and regulatory risk, e.g. the grandfathering of long term infrastructure investments to prevent post-closing changes in law and regulations altering the risk profile of projects, thus protecting the return to investors;
(ii) more balanced risk sharing by public authorities, e.g. limited usage guarantees for toll roads; the development of schemes such as the UK Guarantee Scheme and the European Fund

for Strategic Infrastructure (EFSI) guarantee scheme; (iii) more tailored treatment of assets for capital charge purposes (see further question 12 below and we endorse the comments made by the ICMA in its response submitted on 30 April 2015 (the "ICMA Response") at paragraph 10); (iv) ensuring a consistent project pipeline, e.g. through publishing of details of European infrastructure projects; the proposed new European Investment Advisory Hub. We also endorse the comments made in the ICMA Response to Q12 regarding pipeline, policy changes, procurement procedures and extension of scope of credit enhancement vehicles.

Attention should be given to national barriers to investment (e.g. withholding tax treatment on loans and private placements) and opportunities for specific types of investors (e.g. pension funds pooling). For example, a particular barrier for some institutional investors making equity investments in greenfield projects is the requirement for investors to receive a 'running yield' during the construction phase when there is no income stream available. Allowing a return on equity during construction is not usually acceptable to lenders of senior debt. When standardised industry documentation is developed, this requirement for institutional investors needs to be addressed.

A wider concern is that Solvency II imposes a substantially higher charge for holding the most senior tranche of a bond backed by securitised commercial real estate debt (if it has a duration of 3 years or more) than the charge it imposes for owning the commercial building on which the debt is secured.

We also endorse the comments made in the ICMA response to Q10 in paragraphs 66-69 on fragmentation in the pension market.

For SMEs and innovative and high growth start-ups, the "Bridging the Gap" report identified a number of areas, including (i) a lack of awareness of different funding options for SMEs, particularly equity funding; (ii) high issuance costs for small firms; and (iii) unfavourable market conditions for securitisation of SME loans.

That said, any compulsion as to the way that institutional investors should invest their funds (which represent household savings) is concerning because their primary objective should be to act in the best interests of those households.

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?

Steps could be taken to remove barriers and reduce the costs to fund managers of setting up and marketing funds across the EU.

- Further harmonisation of both the UCITS and AIFMD passport regimes is necessary, particularly to remove additional fees and requirements that have been imposed at the national level, or to overcome the different approaches to what constitutes "marketing" a fund across states and whether permissions are required to do so (see below). For example, under AIFMD, some member states charge an additional fee for processing marketing passport applications for EU AIFMs from other member states and some have imposed additional requirements. France, for example, requires the appointment of a local paying agent. Similar issues also arise for UCITS funds and, in due course, ELTIFs, given that ELTIFS must be AIFs prior to obtaining the ELTIFs designation.

- For non-EU AIFMs further harmonisation of the available marketing registrations under AIFMD national private placement regimes is required.

There are currently a number of practical issues for non-EU AIFMs which can discourage marketing activity:

- Lack of clear regulatory guidance on what constitutes 'marketing' under the AIFMD.

  It is unclear when non-EU AIFMs will be required to register under national private placement regimes of an EU member state and how much "pre-marketing" can be carried out to gauge investor interest in a jurisdiction before deciding on AIFMD registration.

- Lack of clear regulatory guidance on what is meant by "reverse-enquiry" .

  The lack of guidance on the point under AIFMD is made even more challenging because, historically (i.e. pre-AIFMD) there have been variations across the EU as to how regulators have interpreted "reverse solicitation". Some EU regulators historically applied a "relationship" approach to reverse solicitation – if the original contact with an investor was established in line with marketing requirements, then it was possible to reach out to an investor on similar new investments in the future, and that would not be considered "marketing". However, other EU regulators applied a "transaction by transaction" approach – notwithstanding that you might have an ongoing relationship with an investor, a manager would need a "fresh" reverse solicitation for each and every transaction/investment. Post-AIFMD, it is not clear to what extent those differing approaches still exist.

  The need to reach a consistent understanding of the exact scope of "reverse solicitation" under the AIFMD is also likely to increase because of other, imminent EU regulatory developments, notably MiFID2. MiFID2 defines "reverse solicitation" differently from AIFMD, referring to contact needing to be at the "exclusive initiative" of an investor. Clearly, it is not desirable to have divergence on what activities constitute "reverse solicitation" under two key pieces of EU Regulation.

- Varying timelines and processes between member states for AIFMD marketing registration by non-EU AIFMs.

  For example, in some cases it is a simple prior notification, in other cases it is a prior approval requirement which can take months. Some member states have also "gold-plated" the marketing registration to require the appointment of a depositary (which typically is only a requirement for EU AIFMs).

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

The lack of a clear definition of "infrastructure" can lead to unfavourable regulatory treatment. The specialised nature and risk profile of infrastructure financing should be recognised and distinguished for capital charge purposes from, for example, long-term corporate debt. For insurers in particular, the implementation of the Solvency II regime does not incentivise investment in infrastructure and so the recommendation is that they be treated as a separate asset class for regulatory purposes.

The technical advice that the European Commission has requested from the European Insurance and Occupational Pensions Authority (EIOPA) on this issue will need to be considered when it is available. EIOPA is exploring the development of an infrastructure asset class which could be given more appropriate treatment for the purposes of Solvency II to reflect that these assets are held until maturity and to reflect their low loss-given default. However, this analysis should not be considered in isolation, and other asset classes may benefit from similar scrutiny, e.g. securitisations and real estate.

Under the existing rules of Solvency II, the provision of a rating for an asset can allow for more favourable treatment. Some assets are rated by an External Credit Assessment Institution (ECAI), although the costs can be considerable for smaller projects. Some larger insurers construct their own internal models to give a more accurate reflection of the risk profile of a particular investment.

In our view, this method could be developed further. Many European infrastructure projects are supported by European or member state government backing in one form or another, reducing credit risk, construction risk and other project risks. This support takes the form of a guarantee of a portion of the project debt (e.g. by EIB or under the UK Guarantees Scheme or the EFSI Scheme), or the use of prescribed standard-form documentation as part of a government backed PPP / PFI scheme. A practical solution could be for such assets to be given a predicted rating for the purposes of Solvency II. This proxy rating would be given by the relevant entity, e.g. EIB, following its analysis for the purpose of issuing the relevant credit enhancement or assessing whether the requirements of the applicable PPP/PFI scheme structure have been implemented.

Similarly, where an insurer is investing alongside a bank which is using an internal model which has been approved by the relevant banking supervisor, the bank's rating of the investment could be used for Solvency II purposes. More generally, rating agency regulation should be restructured to promote an efficient, transparent and competitive private ratings sector, since the existence of such a sector is essential for the proper functioning of a capital market. Risk assessments provided by banks and other lenders should not be classed as ratings and should fall outside the regulatory regime.

With respect to future reviews of prudential rules for banking under CRDIV/CRR, the types of assets described above should be prioritised.

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

In principle, the introduction of a standardised product could assist in strengthening the single market in personal pension provision but we are doubtful that this could be achievable or workable in practice.

Our experience of IORP (the EU Pensions Directive that paved the way for pan-European occupational retirement provision in 2005) is that it is flawed, principally because pension systems work so differently in the member states, particularly with regard to rules on tax relief and investor protection. Additionally, stringent funding requirements (such as the need for the cross-border pension plans to be "fully funded" at all times) and the need for such plans to be administered in accordance with the social and labour laws of the relevant member state has resulted in a very poor take up rate.

The personal pensions market in the UK is huge whilst in other EU countries relatively small. There are therefore likely to be similar problems of differences to overcome in attempting to create a 'one size fits all' product that will be competitive and cost-effective for all countries to adopt. Introducing an EU wide product is likely to increase complexity for investors and could potentially lead to regime shopping by providers.

However, if it were possible to overcome these barriers, then it would be an attractive prospect in terms of economies of scale regarding investment and adviser fees that would be achieved and simpler administration. The development of pension schemes in the EU has the potential to have a positive impact on EU capital markets. An alternative and more practicable approach, rather than standardisation, would be for the European Commission to seek out national best practice to increase the size of the market, e.g. the UK's auto-enrolment policy, which has had a significant impact on overall participation in workplace pensions.

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?

To make it easier for large fund managers to run EuVECA and EuSEF funds, the current requirements should be reviewed with a view to minimising complex, additional requirements that vary across member states and which may act as a disincentive to using the EuSEF and EuVECA designations.

We note that the purpose of the EuVECA and EuSEF Regulations is to offer an EU marketing passport to "small" EU AIFMs, i.e. EU managers of unleveraged close-ended AIFs with assets under management under €500 million. However, it should be taken into account that the use of the EuVECA and EuSEF designation is not exclusive to small EU managers. Indeed, in its Q&A on the application of the EuVECA and EuSEF Regulations, ESMA clarified that EU AIFMs above the AIFMD €500 million threshold, as well as EuVECA or EuSEF managers that subsequently exceed the AIFMD €500 million threshold, may also make use of the EuVECA or EuSEF designation, provided that they comply with the requirements of the AIFMD and certain provisions of the EuVECA and EuSEF Regulations.

Therefore, large EU fund managers authorised as EU AIFMs under the AIFMD can, in theory, also apply to set up and operate EuVECA/EuSEF funds under the EuVECA and EuSEF Regulations. However, because of the additional compliance burden this would bring, the precise benefits/advantages for large EU AIFMs already authorised under the AIFMD and, for some also authorised as UCITS management companies under the UCITS Directive, are not obvious. Indeed, it is not certain that the introduction of a third regime for above-threshold AIFMs, in addition to their AIFMD and potentially UCITS licences, is necessary or desirable. This would introduce new requirements including, on the type and percentage of qualifying investments/ portfolio companies that can be acquired, without necessarily offering clear additional benefits in terms of fund-raising and marketing of regulated investment funds across the EU.

In particular, it should be noted that regimes intended to promote social investment and venture capital have already emerged in the EU. In Luxembourg, for instance, the LuxFLAG agency grants 'labels' in microfinance and responsible investments, as well as in environmental, social and governance performance to investment funds and other vehicles subject to a level of national supervision equivalent to that which exists for investment funds in EU countries. These vehicles can qualify as large EU AIFs, for which the benefit of the AIFMD passport already exists, and they can be structured and used within well-known and well-tested regulated investment vehicles (e.g. a SIF) without the need for a separate EuVECA and EuSEF designation.

In light of the above, we are not sure that the EuVECA and EuSEF regimes are necessary for large EU fund managers already authorised as EU AIFMs under the AIFMD, and there is some scepticism as to whether the EuVECA and EuSEF Regulations can make it easier for larger EU fund managers to run these types of funds, given the added rules it brings on top of compliance with the AIFMD. Indeed, the AIFMD framework is, in our view, sufficient for above-thresholds EU AIFMs that can encompass their venture capital and social products in their existing AIFMD framework.

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

We welcome the emphasis the Green Paper places on private equity (PE), as well as venture capital (VC), being a significant and important alternative source of financing for infrastructure and SMEs. After the 2008 financial crisis there was recognition across the EU that SMEs and mid-market companies were essential to the recovery of the European economy. PE and VC have played an important part in that recovery by providing an alternative source of finance to SMEs and infrastructure projects operating across the EU. We agree that boosting the scale of both PE and VC investment will play an important part in reducing reliance on bank funding across the EU. The long-term nature of the structures used by PE and VC to raise capital to invest means they are ideally placed to invest for the medium to longer-term in both SMEs and long-term infrastructure projects. In our view, the EU can help further develop this alternative source of finance in the following ways:

- Ensure the PE and VC industry does not become subject to further or unduly onerous regulation. Alternative investment managers operating in the EU have recently become subject to the Alternative Investment Fund Managers' Directive, the most significant piece of EU regulation ever to affect it, and fund managers are still in the early stages of compliance with that directive. Some member states are yet to fully implement the Directive, so there is still an element of uncertainty in this area. The European Commission should take care to ensure that if any changes are made to existing regulatory regimes so as to affect PE and VC fund managers (including any changes to the EuVECA regime and the introduction of the ELTIF regime), they are done so proportionately so as not to deter fund managers from seeking to raise and deploy their funds in the EU.

- There is also significant uncertainty around marketing private funds across the EU – particularly for non-EU fund managers. It will be important to ensure that any changes proposed as a result of the CMU do not impose any additional unclear or even unnecessary regulatory requirements on PE and VC managers as this may deter them from seeking to raise capital from EU investors, which in turn could reduce the levels of PE and VC funding available to deploy in these jurisdictions.
- The European Commission should ensure the AIFMD marketing passport is extended to non-EU AIFMs (and EU AIFMs managing non-EU AIFs) as soon as possible. This will make it easier for non-EU AIFMs raising PE or VC funds focussed on investing in the EU (and EU AIFMs raising similarly focussed PE and VC funds though non-EU AIF structures) to raise capital for these funds much more easily than is currently the case. ESMA issued a Call for Evidence on the AIFMD Passport and Third Country AIFMs (ESMA 2014/13/14 dated 7 November 2014) regarding the approach ESMA will take to determine those non-EU countries which satisfy the criteria for extension of the AIFMD passport.

  Only the funds or managers of the non-EU countries that satisfy the criteria set out in Article 67(4) of the AIFMD would benefit from the extension of the passport, and ESMA will not treat all non-EU countries as a single block for this purpose. In this regard we are concerned about the potential impact of the criteria of "monitoring of systemic risk", as mentioned in Article 67(4) of the AIFMD, if this is interpreted as requiring "reciprocity" or "equivalence" between a non-EU country's regulatory regime and that of the EU. Experience from the implementation of EMIR in the OTC derivatives context shows that satisfying the test for reciprocity and equivalence is a hurdle not easily overcome. We are particularly concerned that if the approach currently being taken under EMIR is introduced in the investment management sector in respect of determining those non-EU countries which satisfy the criteria for extension of the AIFMD passport, it is likely to reduce significantly (and delay) the number of non-EU countries qualifying for the passport. We believe this would reduce investor choice without meaningfully increasing investor protection, and would inhibit the further development of PE and VC as an alternative source of financing for the European economy.
- Among some of the biggest investors in PE and VC funds are institutional investors such as pension funds and insurers. The amounts these types of investors will be able to commit to PE and VC in the future will be affected by the capital treatment they are required to give to these investments under the CRD IV and Solvency II. The European Commission should do all it can to ensure that the need for appropriate solvency requirements is carefully balanced with the need to promote investment into PE and VC funds, so as not to unduly restrict insurers and pension funds from investing in the sector (see also comments in Q10 above).
- We would also welcome any ways in which the European Commission can help raise the profile and public perception of PE and VC investors as important sources of capital to boost the European economy. After the 2008 financial crisis, the industry became subject to

negative publicity. PE and VC funds investing in businesses and infrastructure projects across the EU are now subject to strict transparency requirements, as well as detailed anti asset-stripping requirements and portfolio company rules. This should enhance public confidence in PE and VC funds as sources of alternative financing and this should be promoted publically by the European Commission wherever possible.

- The introduction of the ELTIF regime may also help develop PE and VC as alternatives to bank funding (please also see our response to question 3 in relation to encouraging the take-up of ELTIFS), but care should be taken to ensure that PE and VC managers already authorised as EU AIFMs are not subject to conflicting or unduly onerous additional regulations if they decide to raise an ELTIF alongside any private equity structure investing in the EU. We note that the European Commission is proposing to review the existing EuVECA regime and, again, we welcome this.
- With respect to exit opportunities, we welcome the European Commission's proposals to simplify prospectus requirements under the EU Prospectus Directive, and streamline the process where possible, as this should help to make exits via IPO a more attractive option for PE and VC managers. Lack of exit opportunities may inhibit investment by PE and VC funds, particularly in businesses in start-up or growth capital stages.

  Note that care should be taken in reviewing the EU Prospectus Directive that private funds such as PE and VC continue to be able to make use of an exemption from the requirement to produce a prospectus, because those private fund offerings are already subject to detailed transparency and disclosure obligations under AIFMD.
- We note that the Green Paper places an emphasis on helping to promote alternative sources of funding for infrastructure projects but does not refer, from a policy perspective, to the real estate industry. We work closely with many real estate fund managers who invest in real estate assets across the EU, many of which have an infrastructure element or are linked to an infrastructure project. We would urge the European Commission to consider the real estate industry alongside infrastructure, as encouraging investment in private real estate funds will increase the alternative sources of funding available for both direct real estate investment and development projects in the EU. This in turn will stimulate SMEs operating in, or directly related to, the real estate sector (such as construction companies, materials suppliers, architects, planning consultants, designers). We note, however, that ELTIFs are permitted to invest in real estate assets and this is welcomed.

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

The key impediments to bank finance for companies that need finance are capital requirements and return on capital restraints. Any further regulatory reform should incentivise long-term lending and risk-based pricing. Pre-financial crisis obstacles, such as the restriction of the loan market to lending banks, which prohibits new financiers from funding SMEs, and overly tight consumer credit lender restrictions which potentially inhibit crowdsourcing of start-up capital, need to be addressed by identifying measures that should be repealed.

Secured lending by both banks and non-banks in many European jurisdictions is hampered by high-security registration costs, particularly with regard to real estate. This is the case in Belgium and Spain, which have very high mortgage registration costs. This does not prevent lending but makes it expensive. In addition, the lack of standardised procedures for taking and enforcing security makes cross-border lending significantly more complex and expensive.

The importance of the real estate sector should not be overlooked. In the US, there are many listed property companies and REITs. This is a relatively small market in Europe but real estate is a significant industry across Europe, which is overwhelmingly funded through bank finance although it is increasingly funded by non-bank lenders such as insurance companies and debt funds lending directly. Arguably, however, such investors might prefer to invest through capital markets in real estate if such opportunities were available. Investing in real estate is also attractive to insurance and pension fund investors due to the long-term nature of the investment (as with infrastructure), so it should also be considered by the EU as an important funding tool for the real economy in funding offices, shopping centres, hotels and warehouses/industrial as well as student housing and residential housing.

The main impediments to non-bank direct lending across Europe are regulatory barriers to entry such as inability to lend in certain jurisdictions such as France (i.e. banking monopoly rules) and inability to enforce without a licence in certain jurisdictions (e.g. Germany). In some jurisdictions such as the UK, only consumer lending requires a licence, but in many jurisdictions, commercial lending also requires a licence.

In terms of cross-border non-bank direct lending, withholding tax is often an issue, for example in Italy it is very difficult for non-Italian banks to lend without WHT. In certain jurisdictions it is very difficult to syndicate to non-banks due to WHT or lending restrictions or both.

There has been a very significant increase in the number of fund managers raising capital for private debt/credit funds over recent years, in response to the need for non-bank lending in the wake of the financial crisis. Whilst debt/credit funds structured as alternative investment funds are subject to harmonised regulation under AIFMD, non-bank lenders such as this are subject to many different national regulations, particularly with regards to banking licensing requirements, as described above. The European Commission may wish to consider some pan-European exemptions for smaller debt fund managers lending below a certain amount to SMEs and infrastructure projects, to help promote debt funds as an alternative source of direct lending for companies that need finance. Ireland and Luxembourg have recently made regulatory changes to facilitate the operation of direct lending funds, which has helped asset managers establish private debt vehicles in these jurisdictions. The European Commission should encourage other member states to do the same.

Whilst the European direct lending fund market is still a nascent market, certain member states have already implemented schemes to support direct lending funds. For example, the UK government has supported the Business Finance Partnership, established to incentivise direct lending funds to lend to mid-market companies. The UK government has invested £1.2bn in direct lending funds, with this figure to be matched by private investors. The scheme only supports British companies (by lending to companies with a turnover of up to £500m and lending to other lenders that provide finance to companies with up to a £15m turnover). The European Commission could consider supporting a similar structure to help promote directly lending to SMEs and infrastructure projects across the EU.

Measures to develop and integrate capital markets - developing and diversifying the supply of funding – boosting retail investment

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

Among other recommendations to increase cross-border retail participation in UCITS, the industry could try to put the following initiative on the UCITS VI agenda:

- To create of a favourable tax regime for UCITS in order to make cross-border fund-raising easier. Indeed, UCITS IV and UCITS V introduced several reforms that may have been potentially ignored by promoters and investors due to tax uncertainties in cross-border fund operations.
- To abolish the formalities of the notification procedures in view of reducing the related costs and the ensuing notification fees for investors.
- To increase confidence of investors in UCITS (for instance by simplifying the UCITS rules).

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

The ESAs can further contribute to consumer and investor protection by ensuring that Level 2 measures and Level 3 guidance issued in relation to the numerous pieces of legislation designed to protect investors and consumers, notably MiFID2, Solvency II, IMD, PRIIPS and UCITS are, as much as possible, complementary. To take an example from the insurance sector, there is a risk that the duplication of disclosure requirements between Solvency II and the PRIIPs KID Regulation could result in information overload for consumers – causing confusion rather than simplifying purchasing decisions.

In addition, EU regulatory requirements should be harmonised as far as possible with the requirements of regulators outside the EU.

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

Steps could be taken to increase retail investment in capital markets, as there are a number of barriers which inhibit this, such as a lack of financial expertise, a preference for real estate as an asset class and, bearing in mind recent mis-selling cases, a general mistrust on the part of the investing public in financial markets and financial intermediaries.

A first step might be to consider the cumulative impact of recent regulation intended to improve investor protection, for example in MiFID2, UCITS and PRIIPs, to make sure that the requirements are consistent and that retail investors are able to make informed decisions on the risks and costs associated with different types of investment.

However, further legislation might not necessarily be the most appropriate policy response. One of the steps that might be taken, for example, is to improve financial education and for the financial industry to develop simple, easy-access savings products that are easier for retail investors to understand.

Making products as simple as possible would be beneficial to retail investors. It would be possible to have a further, more simplified retail market (to sit alongside the current market for retail denomination bonds), which includes only very simple products and nothing that might run contrary to consumer protection laws in any country (for example consider early redemption without compensation in Belgium). The further simplified retail market could also include default insurance as part of the offering. This could be along the lines of deposit insurance for bank deposits, i.e. only of a threshold amount (so that some risk remains, but the downside is limited for households). Such an insurance scheme could be automatically entered, and centrally organized within Europe. It would also be funded by a payment from the issuer on issuance as a one off cost of utilizing the market.

Generally speaking, retail investors in the EU are more risk-averse than investors elsewhere in the world, notably the US. Efforts to change this, to establish an "equity culture", are likely to take a long time to come to fruition. As a larger proportion of retail investors are more likely to invest in financial markets indirectly than directly, via a UCITS fund, for example, policy measures aimed at boosting retail investment in UCITS funds may prove more effective in the short term. Similarly, tax incentives for personal pensions might be effective, given that for many retail investors, their biggest investment in the financial markets will be through their pension.

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

We are not able to suggest any national best practices that could be exemplars**.**

Measures to develop and integrate capital markets – developing and diversifying the supply of funding – attracting international investment

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?

There are additional actions in the field of financial services regulation that could be taken to improve Europe's competitiveness. However, this does not necessarily mean that *new* legislative measures are needed. In our opinion, the focus should be on reviewing existing regulation, assessing its impact and identifying any unintended consequences, rather than on introducing new regulation, particularly as the cumulative impact of the major financial reforms are not yet fully understood, given that some key components of EU financial services regulation (e.g. MiFID2,) are still to be implemented.

For example, the disclosure regulations surrounding securitisation transactions are now so numerous and diverse that they are proving extremely cumbersome, not only for originators and sponsors, but also for investors – the notional beneficiaries of all the new disclosure requirements – who have to check multiple sources to ensure they have all relevant information to make an investment. Under EU rules alone, a prospectus for a public securitisation transaction has to, in practice, consider five different disclosure standards (the Prospectus Directive, Article 407 of the CRR, Article 409 of the CRR, Articles 52 and 53 of the AIFM Regulation and Article 256 of the Solvency II Delegated Act) administered by three different regulators (ESMA, EBA and EIOPA). Loan level data thereafter will have to be supplied to three different standards in three different places, to fulfill the requirements of the CRA Regulation, the eligibility criteria for Eurosystem credit operations set out by the ECB and the eligibility criteria for the Sterling Monetary Framework operations set out by the Bank of England. In addition, the Transparency Directive (which is normally gold plated by local listing rules), the Market Abuse Regulation, the Credit Rating Agencies Regulation, the CRR, the AIFM Regulation and the Solvency II Delegated Act all impose ongoing disclosure obligations articulated differently and measured by different standards. Even where the content of the disclosure is the same, it is often necessary to disclose or file it in multiple ways (e.g. timely disclosure under Article 17 of the Market Abuse Regulation has to be publicly disclosed, filed under Article 21 of the Transparency Directive and uploaded to a website established by ESMA under Article 8b of the Credit Rating Agencies Regulation).

If new regulation is thought necessary, it should only be introduced after a thorough impact assessment and, in order to reduce the risk of regulatory arbitrage, which would put European firms at a competitive disadvantage, the assessment should take into consideration the cumulative effect of national and EU regulations and include a comparison of the EU position with the position in other major jurisdictions. It should also include a full cost-benefit analysis, taking into account the costs already incurred and soon to be incurred by the raft of regulations already introduced.

It may be the case that non-legislative, market-led initiatives, such as the recent work in the European private placement market, are preferable to new legislation.

Examples of additional actions in the field of financial services regulation that could be taken include:

- Assessing the impact of EU regulation on 'third countries', such as the USA and those in Asia. Issues around 'third country equivalence' pose barriers to cross-border capital flows, as has been seen recently in relation to OTC derivatives. A coherent approach to "equivalence" across EU legislation (e.g. AIFMD, EMIR, MiFID) should be developed as soon as possible and equivalence decisions should be given in a timely manner.
- Increasing regulatory co-operation. In this context, we welcome the efforts made by IOSCO in tackling the key challenges faced by regulators in implementing cross-border securities regulations, including how their national rules will apply to global financial markets and interact with foreign rules and international standards.
- Making European markets more integrated in order to attract non-EU investors and increase competition. Currently, non-EU fund managers do not benefit from an EU passport. Extending the AIFMD marketing passport to both non-EU AIFMs and non-EU AIFs would increase competition and investor choice.
- Assessing the barriers that exist in many countries to lending to corporates. In

particular, in many countries (e.g. France, Germany, etc.) this is covered by the banking monopoly or otherwise requires a licence. This is a barrier to lending by banks that do not benefit from a passport (e.g. non-EU banks lending cross-border into the EU or through an EU branch) as well as to non-bank lenders (funds, insurance companies, finance companies, etc.), even if they do not fund themselves by taking deposits. These restrictions affect the ability of a range of lenders to deploy capital in the EU to fund investment by corporates.

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

Measures to integrate international capital markets could facilitate access by EU firms to capital markets in third countries. This might be done through:

- Strengthening international regulatory co-operation in order to co-ordinate regulatory supervision inside and outside Europe.
- Consistent international implementation of global regulatory policies, e.g. of the G20 agenda through the FSB, BIS and IOSCO, as conflicting regulatory policies and divergent implementation of global standards create barriers to capital flows and reduces market efficiency. There are instances of the EU considering more stringent policies than have been recommended by the G20, e.g. in relation to securities financing transactions. We note, in this context, a recent survey conducted by ISDA which found that more than half of derivatives end users think OTC markets are fragmenting along geographic lines as a result of regulatory change, and a majority consider that this is having a negative impact on their ability to manage risk. This appears to be inconsistent with the aims of Capital Markets Union to facilitate cross-border capital flows.

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

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

We have set out three suggestions below, but, as a general comment, we would also endorse the response on this question submitted by the ICMA on 30 April 2015. In addition, some of the discussion in the ICMA 1 May 2015 response to the Prospectus Directive Consultation Paper would be relevant in relation to this Q.23.

- **Clearing systems:** One of the first steps towards CMU should be to look into the functional connection of all existing clearing systems within the EU (for example, an investor with an account in Euroclear Finland should be able to instruct the trade of securities in the Portuguese Interbolsa system). By strengthening (and expanding where necessary) the current connectivity of the clearing systems, this would promote liquidity. It is possible that this already technically exists indirectly through Euroclear and Clearstream, in which case looking at how such a patchwork of clearing systems works, and how that functionality could be improved, would be an important next step thereafter.

By improving the information exchange available, and reducing the steps needed to execute trading in securities in other jurisdictions, it may be possible to improve the efficiency and liquidity of pan-European bond trading without replacing the existing clearing systems. Promoting the interconnection of local systems also retains an element of local sovereign control, and promotes competition to an extent. It also retains the ability of individual jurisdictions to use the domestic clearing systems for fiscal policy. However, the issue of legal enforcement against assets in clearing systems and relevant immunity issues should be looked at to ensure harmonisation.

- **Liability regimes:** The benefit of improving cross-border flows and facilitating access to securities in (and across) different jurisdictions to improve liquidity is highlighted in our response to Q. 6. One way to encourage this might be to give more consideration to stream-lining liability regimes for issuers of shares or bonds. Whilst it is not practicable (or, perhaps, desirable) to seek to create a uniform liability regime across the EEA, there would be a benefit in enabling issuers of shares and bonds to have greater control over the law and jurisdiction to which it might be subject (such as, for bonds, by reference to the governing law of the bonds).
- **Parallel local domestic markets:** Conversely (and completely separately), giving member states the ability to create parallel local domestic bond markets, which would be outside the scope of the Prospectus Directive, might encourage more issuance by SMEs in their local jurisdiction. member states might choose to implement some of the suggestions which we suggested in Q. 5 (for example, in relation to specific SME markets or risk management) at a national level to support the local economy.

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

Progress has been made in developing a single rulebook, although, as it is a relatively recent development, it would benefit from more time to become fully established. Lack of harmonisation has been an issue (e.g. in the implementation of AIFMD) and the increasing adoption of directly applicable EU regulations recently has helped to address this. As, ultimately, the success of the single rulebook will depend on the detailed implementation and enforcement of the rules, we would like to see improvements in the Level 2 rulemaking process, e.g. sufficient time to respond to consultations.

Currently, there is insufficient flexibility in the application of legislation and in the correction of legislative errors (e.g. drafting errors). We think this should be addressed. Given the volume of new regulation and the speed with which it is introduced, it would be beneficial to introduce a mechanism to amend legislation quickly, create legitimate exceptions and provide guidance if necessary.

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

We think that the powers of the ESAs to ensure consistent supervision are, broadly, sufficient and that there is no need for a single, "EU-level" supervisor. However, improvements could be made, e.g. consistent application of the single rulebook across the EU, under the existing supervisory structure.

We note recent discussions on these issues and the European Commission's recent report on the ESAs[1]. We agree, in particular, that the work of the ESAs is often hampered by a number of factors, including:

- Marginal input to the Level 1 legislative process - enhancing the ESAs' input and provision of technical support and expertise in the Level 1 discussions would provide a means to improve legislative proposals and to ensure that the ESAs were able to understand the intentions that lay behind them.
- Inadequate funding
- Lack of resources
- Insufficient time to ensure proper consultation in relation to Level 2 rulemaking – giving the ESAs more time to complete their Level 2 work would be beneficial, allowing sufficient time for consultation with practitioners and regulators on the detail of Level 2 measures. There have been several recent examples relating to major pieces of legislation where this has been an issue, e.g. AIFMD, the MiFID II/MiFIR Consultation and Discussion Papers, where little over two months was given to respond to an 844 page document and the Short Selling Regulation.
- Insufficient flexibility in the application of legislation and in the correction of errors, developing a mechanism for the ESAs (subject to appropriate oversight) to correct errors and improve legislation through the Level 2 process would be beneficial.

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?

European legislation is not, at present, ideal in terms of enabling market users to identify unambiguously a single system of law which determines the rights to property comprising dematerialised securities. Securities are typically held via a chain of intermediaries/custodians located in different countries. Different countries' traditional legal systems may regard the intermediary as absolute owner or may have "divided" ownership laws where an intermediary may be regarded as a trustee or fiduciary and only treated as the "owner" for some purposes. Where the holding chain includes countries using more than one of these legal systems it is almost always confusing and sometimes gives rise to significant legal uncertainty. (For example, in the Lehman-related litigation, one case had to consider whether an "absolute" transfer of title implicit in a repo transaction was not in fact "absolute" because the rules about defence against third party claims might belong to a different country from that expected by the parties to the repo transaction.) This kind of uncertainty adds to the cost of transactions because additional legal due diligence is required, and in some cases no clean legal opinion is possible, leading parties to take other measures to protect themselves.

Attempts to harmonise the approach to conflicts of laws have stalled. The Securities Law

[1] Report from the Commission to the European Parliament and the Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision August 2014).

Legislation proposal included some valuable clauses, based on internationally-agreed text. Those clauses would, if adopted, clarify that a single "relevant account" should be identified when a legal question arises, and the legal question would be resolved by reference to the law of the place where the relevant account is maintained. The legislation would provide a test to enable the place where an account is maintained to be identified. These clauses would appreciably improve legal certainty in multi-tier holding patterns.

Unfortunately, the proposal for the Securities Law Legislation was allowed to develop and expand, and, in its latest pre-draft iteration circulated to the member states for comment, included material relating to investor protection (shareholder rights and re-use of securities). These additional measures are not central to the conflicts-of-law issue and are not necessary for resolution of the questions of legal certainty. They may be justified from a policy perspective, but they belong properly in a measure such as MiFID or the Shareholder Rights Directive: including them in a law which is not intended to address any substantive legal questions but only to identify relevant systems of law makes the whole measure more controversial.

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

The Financial Collateral Arrangements Directive has been very helpful to add legal certainty in the areas of collateral and close-out netting. A few gaps remain which continue to cause difficulty and therefore add to the expense and friction involved in financial transactions. These can be summarised as follows:

- The Directive does not include a clear test to identify the "relevant account" (see response to Q 26). It would be helpful to add this or to have the relevant part of the Securities Law Legislation brought into force. Particular difficulty arises in a case where the collateral-taker is also acting as account-provider to the collateral-provider. This situation should ideally be clarified by stating that the only relevant account is the account on the books of the collateral-taker (not any other intermediary).
- The Directive requires the collateral-taker to obtain "possession or control" of the collateral to obtain a valid qualifying security interest in book entry securities collateral. Unfortunately the Directive does not define "possession or control". In some member states very complex legal debate has ensued, in particular suggesting that a custodian (account-provider) does not have "possession" of securities solely by virtue of holding the securities in a CSD or with a sub-custodian, and must therefore have some additional "control"; what this extra "control" might be is not defined by the Directive and so gives rise to very significant legal uncertainty. Additional definitions in the Directive would go some way towards clarifying the position.
- The Directive does not ensure that a close-out netting clause has effect in accordance with its terms except where part of a financial collateral arrangement. This means that in some member states it is still not

possible to guarantee the effectiveness of close-out netting at all, unless a financial collateral arrangement is also used; and in many member states the availability of effective close-out netting is limited to certain transaction types, notwithstanding that the parties are "eligible" parties within the meaning of the Directive.

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?

There are a number of areas that might warrant further examination to see whether further integration might be beneficial to business within the EU, for example, making the process easier for companies to re-domicile from one member state to another and looking again at whether a Private European Company structure might be adopted. However, there are significant cost implications for businesses involved in the implementation of new legislation/regulation which must be weighed against the benefits of any change in these areas. The Green Paper highlights that very few SMEs have established a presence in the EU (whether by way of JV, subsidiary or branch), but there is little evidence to demonstrate that this is, in fact, due to lack of harmonisation between company laws in member states. Without further investigation which provides evidence to suggest that this is the case and that, in pursuing further harmonisation, cross border activity would be made significantly easier for SMEs, the costs of further harmonisation would not be justified.

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

Current legal framework

Europe

As a starting point, it may be worth noting that certain capital market transactions in various European jurisdictions (for example, Germany, Italy and Spain) are sometimes structured using special purpose vehicles (incorporated, for example, in Luxembourg), using issuers which are insolvency remote or by establishing a ring-fenced pool of assets. In this respect, the structuring of the transaction is deliberately designed to minimise the potential impact of insolvency in any event.

UK

By way of further example under the current operation of UK insolvency legislation, certain rated capital market transactions are generally structured to avoid the effects of formal insolvency proceedings. In this respect, a harmonisation of insolvency law across Europe would have a limited effect on the way the current market operates in the UK. By way of explanation, since 2003 and the changes introduced by the Enterprise Act 2002 and, generally speaking, focus from an insolvency perspective in relation to businesses in distress has been to promote rescue by encouraging the use of the administration process (i.e. a formal insolvency regime which promotes company rescue). The use of administration, a collective insolvency process for the benefit of the general body of creditors, as opposed to administrative receivership, was designed to redress the balance between secured and unsecured creditors, with a view to promoting a rescue culture, rather than the receivership regime which usually results in the closure of the business. There are various exceptions to the use of administration, one of which applies in relation to significant capital market transactions. The effect of this exception is to continue to permit the appointment of an administrative receiver who then essentially has the role of enforcing the security for the benefit of the investors and avoiding the effects of insolvency altogether. The exception was based on the government's policy at the time that "very specialised financing structures are used in business today for which the ability to appoint an administrative receiver is vital to maintain control and ensure continued cash flows or repayments to the appointer". The capital market definition which is contained in section 72B of the Insolvency Act 1986 was intended to encompass all types of securitisation structures that fell within the definition. There are two key requirements:

1. that a party to such an arrangement incurs or expects to incur a debt of at least £50m; and
2. the investment is a debt instrument which is (or is designed to be) rated, listed or traded.

It is clear from the Green Paper that the current threshold would be too significant in order to afford the same benefits from a broader capital market union designed to provide access to credit for (amongst others) SMEs. Consideration could be given in lowering this threshold (perhaps considering the threshold currently used in the context of excluding companies from being able to use a small company moratorium under Schedule A1 of the Insolvency Act 1986, which is set at £10m). Obviously, the impact of this would effectively be to reverse most of the effects of the Enterprise Act 2002, in terms of making the incidence of administrative receivership more commonplace, and it would not be in keeping with the rescue culture unless, in conjunction with the reduction of the materiality threshold, further amendments were made to make it clearer that such exceptions really did only relate to capital market transactions. Similar thresholds could be considered in other European jurisdictions. It seems, though, that this would be at odds with the current policies promoted by the UK Insolvency Service designed to encourage rescue rather than liquidation and also the European Commission's Policy of giving entrepreneurs a second chance (see further below).

EU Financial Collateral Directive

In addition, under the current regime, the implementation of the European Parliament and Council Directive 2002/47/EC on financial collateral arrangements (the EU Financial Collateral Directive), also in 2003 in the UK by virtue of the Financial Collateral Arrangements (No 2) Regulations 2003, may also provide for circumstances in the context of capital market arrangements where security arrangements benefit from falling within the ambit of a financial collateral arrangement as defined in the Financial Collateral Arrangements (No 2) Regulations 2003. This is because one of the effects of the Regulations is essentially to disapply the key aspects of insolvency legislation which would otherwise interfere with the collateral taker's ability to exercise rights in relation to the collateral in an insolvency scenario. It is therefore probably worth noting that in the context of a Capital Markets Union, capital market transactions may currently benefit from the same protection afforded by the EU Financial Collateral Directive. However, it is worth noting that the EU Financial Collateral Directive has not been implemented consistently throughout the EU and, therefore, it would also be helpful to align procedures on enforcement and have a consistent approach to the implementation of the Financial Collateral Directive and, in particular, its application to the enforcement of share pledges.

As mentioned above, many rated capital market transactions which take place at present are structured to minimise the potential impact of insolvency. It is, however, recognised that some may perceive the multiplicity of different insolvency regimes in each member state as putting Europe at a disadvantage in comparison to the US Capital Markets where the US Bankruptcy Code by and large harmonises the federal insolvency process. It should, however, be noted that even in the US, there are two dominant states that provide jurisdiction for bankruptcy cases, namely New York and Delaware, so in this respect it may be considered that the same uncertainties in theory exist in relation to the different federal laws that could apply, but this is circumvented by using the bankruptcy courts of New York and Delaware in the event of corporate failures.

For capital market transactions benefitting from a Capital Markets Union, in the absence of special structuring or exemptions, as a general principle, we agree that it is of fundamental importance to have a predictable and transparent insolvency regime which will give investors confidence in the market so that should the investment not be successful, the investor is able to recover and/or share in any recoveries and participate in a restructuring in a timely and predictable manner. We do not, however, consider that the revised insolvency regime needs to be in the form of a uniform European wide insolvency law or harmonised in all its aspects. In our view it is sufficient to have national regimes which are predictable and efficient and which allow for an analysis of those risks at the outset which can be relied upon in any investment decision being taken or any subsequent recovery action required. It is also worth bearing in mind the fact that insolvency laws are inextricably linked to other substantive law provisions, for example company law and tax law. It would be extremely difficult to harmonise insolvency law in the absence of considering other fundamental areas of the law that are intertwined. In addition, in seeking harmonisation, more uncertainty might be created, leading to the opposite effect to that intended.

Amendments to the European Regulation on Insolvency Proceedings

As recognised in the Green Paper, there are, of course, steps that have been taken to ensure the proper functioning of the European market in relation to cross-border insolvency proceedings. In particular, there are amendments to the European Regulation on Insolvency Proceedings (EUIR) which are due to be approved by the EU Parliament in May or June this year. Generally speaking, while the EUIR does not provide for a uniform substantive insolvency law, it does play its part in reducing the uncertainty for investors in assessing insolvency risk in setting out a framework which codifies how a member state should determine whether it has jurisdiction to open insolvency proceedings, and also imposing a uniform approach to the governing law which is applicable to those proceedings save for certain exceptions, including rights *in rem* which are considered of importance for the granting of credit. The EUIR also provides for the automatic recognition of insolvency proceedings throughout the EU. The amendments include extending the scope of the EUIR to apply to pre-insolvency and rescue proceedings and also the potential for group co-ordination proceedings. In addition, the amendments are to introduce a standardised insolvency claim form and interconnected EU insolvency registers. As part of these amendments, each member state is to provide summaries of the insolvency and restructuring procedures available in their jurisdiction. These will no doubt assist in promoting greater predictability and transparency and be readily available for investors when considering future commitments.

Recommendations on Harmonisation

The European Commission has also produced a Recommendation for harmonisation on a new approach to business failure and insolvency, to encourage member states to adopt (on a voluntary basis) minimum standards to promote the efficient restructuring of viable businesses and provide a second chance where failure arises as a result of external market forces or circumstances. We have also had the benefit of reading the consultation response filed by AFME which, in its response to this question, identifies various elements of insolvency regimes that may enhance the efficiencies of insolvency practices. The themes identified by AFME are broadly reflected already in the European Commission's Recommendation for harmonisation, with the exception of suggesting a consistent approach to valuation and an enhanced role for creditors. In relation to these particular aspects, we consider that they are matters which may be best left to market solutions and practice rather than imposed by virtue of a formal harmonisation of insolvency law. We note that an evaluation of the Recommendation is planned to be published later this year.

Development in insolvency regimes at a national level

In addition, there have already been significant developments at a national level, in particular, the introduction of pre-insolvency/rescue procedures in some of the key European jurisdictions. Whilst the Green Paper suggests that there has been an absence of rules on restructuring and second chance provisions, we suggest that this is no longer the case in many of the key European jurisdictions. It could, however, be said that much of the development on a national level is at a relatively nascent stage.

In addition, we consider that there are a number of areas where there may be further natural convergence at a national level. First, we think that it would be useful to have a standard threshold in relation to voting during the course of restructuring proceedings (so for example having a 75% creditor voting threshold for each of English schemes, Italian *concordato*, French safeguard, Spanish refinancing, etc). Secondly, we think a standard approach to insolvency triggers and directors liabilities may go some way to creating a more coherent cross jurisdictional environment. Natural convergence in these areas may assist with the emergence of a pan-European market.

Finally, it is perhaps worth noting that according to recent statistics published by S&P Capital IQ LCD, post 2008, the European Leverage Finance market has been dominated by the issuance of secured bonds, which, according to figures in respect of 2014, significantly outweigh credit provided by way of traditional lending. Arguably, this suggests that in relation to secured bonds a further harmonisation of insolvency laws is not necessary and that the absence of harmonisation has not so far and will not hinder the future development of a pan-European capital market.

Conclusion

We do not consider that further harmonisation of insolvency laws is required at an EU level and, given the recent changes, in relation to the EUIR and the Recommendation, any further proposals would, in our view, be premature. It should also be borne in mind that much of the anecdotal evidence relating to the challenges that may be presented by having different restructuring and insolvency regimes relate to practical constraints and the lack of transparency and efficiencies in how the regimes are operated as opposed to the limitations of and differences in the insolvency law itself.

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

We set out below some of the issues which we consider to be the main barriers in the field of taxation.

Withholding taxes

We consider that withholding taxes on interest payments are a barrier to efficient cross-border financing of companies between certain jurisdictions. Taking the UK by way of example, although there are wide-ranging domestic exemptions from withholding tax on interest payments made by UK borrowers to UK lenders, withholding taxes on interest payments made to lenders in other EU and non-EU states do apply as a matter of UK domestic law. In the majority of cases, finance providers can benefit from exemptions from these withholding taxes under a double taxation treaty, subject to the completion of onerous UK treaty formalities, but there remain EU (and non-EU) jurisdictions where the treaty between the UK and the finance provider's country of residence does not reduce withholding taxes to zero (for example, Portugal, Italy and Cyprus). Similar issues apply to interest payments made between other jurisdictions.

In addition, other complications can arise for some alternative finance providers such as investment funds. For example, exemptions from withholding taxes may not be available for the fund itself, even if it is both managed from an EU jurisdiction and has amongst its investors a significant number of EU institutions or other entities who could benefit from exemptions from withholding taxes. Even in a case where, in principle, it should be possible to look through the fund, the need to complete procedural formalities to receive a refund of such withholding taxes introduces prohibitive administrative complications and/or may simply be unacceptable to investors.

As a result, the removal of such withholding taxes would remove a significant barrier to more integrated capital markets for two reasons. First, it would facilitate investment by finance providers who can already benefit from an exemption from withholding taxes (whether under domestic law or under a double tax treaty) in jurisdictions where the treaty formalities or formalities required to benefit from a domestic exemption are very onerous. Second, it would allow for finance to be provided between jurisdictions where, under current law, withholding taxes apply (increasing, at least in cash-flow terms the cost of financing).

Financial Transactions Tax & Other Transfer Taxes

One other barrier to fully integrated capital markets within the EU relates to the collection of transfer taxes in different jurisdictions and the lack of a unified approach across different jurisdictions.

In particular, the implementation by a group of EU member states of a very broad FTT, in the form of that proposed in February 2013 (or in very similar form) under the "enhanced cooperation procedure" would, in our view, be extremely detrimental to an integrated capital markets union within the EU. An FTT in this form raises concerns that competition would be distorted within the EU. For example, a US bank would, under the proposals being considered, be subject to the FTT when transacting with a German client, but not when transacting with a UK-based client. Companies and financial institutions that do not want to incur FTT liability may put measures in place to ensure that they do not trade with parties in the FTT zone or in FTT - zone securities thus causing markets to decrease and increasing the costs of capital for businesses. Separately, distortion in the market would likely also arise if debt securities are caught by the FTT charge but loans are excluded from the charge, limiting the flexibility around financing options.

Debt vs Equity

In order to move towards a more robust funding structure for companies across the EU, careful consideration should be given to the tax positions of investors and investee companies in different EU jurisdictions. To take two common aspects of European tax regimes by way of example, the need to maintain particular debt-to-equity ratios in certain jurisdictions and the fact that interest payments on debt financing are often deductible in jurisdictions in which no deduction is available for distributions on corporate equity can in many situations lead to a loss of flexibility in financing options for companies and investors.

BEPS

It will be important that any steps implemented in EU jurisdictions resulting from the Organisation for Economic Cooperation and Development's Base Erosion and Profit Shifting initiative are done with the European Commission's objective of moving towards a more integrated capital markets union in mind.

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?

We would endorse the response on Q. 31 submitted by the ICMA on 30 April 2015.

Recent studies suggest that, whilst larger trades of corporate bonds are still transacted "OTC ", there is an increasing trend towards trading smaller transactions on electronic platforms. Greenwich Associates, quoted in the *Financial Times* in November 2014, estimated that the number of investors trading at least some of their bonds on screen has jumped 80 per cent since 2009. This trend is likely to continue as electronic trading gathers pace and with the "proliferation" of new trading platforms. Two new trading platforms launched at the end of April 2015, for example.

There is, though, an argument that such new technologies are not, of themselves, sufficient to increase liquidity and to promote an efficient market. Electronic trading platforms would need to be supported by regulation to support both (a) market-making and (b) improved pre- and post-trade transparency.

Separately, by ensuring an efficiently connected patchwork of clearing systems across Europe, it would open the ability for trading platforms to develop which could deliver access to the widest spectrum of securities offered across Europe.

Please also see our comments on crowd funding and peer-to-peer lending in Q. 9.

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?

We note that the focus of the Green Paper is to discuss possible policy measures on Capital Markets Union and that the Action Plan to be issued later this summer will provide further detail on the direction specific policies might take. However, while we agree that this is the correct approach in the Green Paper, the focus must not be entirely on the policies covered in the Green Paper; the wider European economic and political context should not be overlooked, since it will inevitably impact the goals of the Capital Market Union project.

For instance, in respect of sovereign debt, more could be done on:

- Transparency – as it relates to sovereign debt - ensuring that the legal terms of sovereign debt are made available to investors in respect of both debt issued under foreign law and domestic law, so that investors in domestic law instruments (in Europe sold and held on a cross-border basis) have the same level of information available in respect to that debt as investors in foreign law debt instruments of the sovereign. More could be done to close the gap also in terms of availability of information as to the legal terms and issuing framework of sovereign debt issued by way of auctions.
- Euro area model CAC – further work could be undertaken to introduce a single limb aggregation mechanism to reduce further the risk of holdout creditor litigation (in this respect further use could also be made of Trustees and sharing clauses).
- Encouraging the adoption of creditor committee provisions in sovereign debt to ensure adequate creditor engagement during debt sustainability crises.
- Development of incentives to rebalance the reliance put on credit ratings as the primary basis for reaching an investment decision (as highlighted elsewhere in our response).
- The exercise of ex-post official sector preferred creditor status - the exercise of such a tool should be carefully considered and disregarded if possible as it can undermine investors' confidence in the market.

In terms of the wider macroeconomic environment, within which Capital Markets Union is to be developed, much of the potentially good work could be undermined if the interaction of each policy initiative is not considered in the context of the prevailing macroeconomic climate; hence consideration should be given as to the interplay between such initiatives and current fiscal, monetary and economic policies. For instance, the relevant Authorities should consider any initiatives against the impact that the ECB's loose monetary policy and low interest rate environment is having and, in particular, the risk of deflation. Similarly, any negative incentives created by the ECB's quantitative easing policies should also be factored in, to ensure there is no "tipping point", where a positive policy measure undermines the very policy objectives the ECB is addressing. More broadly, there continues to be a heavy reliance by national governments on their domestic banks purchasing their domestic debt and while this may help ring-fence an escalating crisis, it also accelerates it.

The impact of initiatives should be tested against economic growth initiatives, especially where policy objectives lead to additional and more intrusive regulation. In that respect, interventionist policies may detract from creating incentives for the private sector to take initiatives forwards and there is a risk that too intrusive regulation could impact negatively on the capital markets. Striking a balance will therefore be important.

Finally, it should be remembered that, as the capital markets of 28 EU member states are markedly different, in terms of size, maturity and culture, a "one size fits all approach" may not be possible or desirable in all circumstances.

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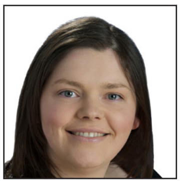

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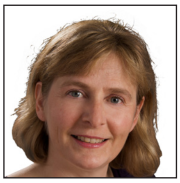

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C L I F F O R D

C H A N C E