AmCham EU
SPEAKING FOR AMERICAN BUSINESS IN EUROPE

Our position

Capital Markets Union package

AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate US investment in Europe totalled more than €3.4 trillion in 2021, directly supports more than 4.9 million jobs in Europe, and generates billions of euros annually in income, trade and research and development.

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Executive summary

The creation of a strong and complete European Capital Markets Union (CMU) is now more important than ever. As the Commission continues its efforts to obtain a unified system of capital markets, there are some principles that should be held at the forefront of its completion, including openness and strength.

The Commission must keep in mind key aspects of the ongoing legislative proposals, such as the European single access point (ESAP) proposal, the Alternative Investment Fund Managers Directive (AIFMD), the Markets in Financial Instruments Regulation/Markets in Financial Instruments Directive (MiFIR/D) and the Central Securities Depositories Regulation (CSDR). Additionally, the Commission should focus its future efforts on establishing an EU-wide system for withholding tax relief, ensuring greater flexibility on the listing rules for public markets and further adopting mid to long-term initiatives for securitisation.

The recent and current circumstances have demonstrated once again the urgent need for coordinated action at both the EU and national level when it comes to financial stability. The CMU Package is a positive development as Europe seeks to ensure the creation of an effective and secure framework for financial actors. With the above modifications and a stronger partnership with the private sector, the proposals have the potential to benefit both businesses and the public interest alike.

Introduction

As outlined in our previous position,[1] the American Chamber of Commerce to the EU (AmCham EU) is a long-standing supporter of the CMU and has welcomed the European Commission's comprehensive strategy outlined in its 2020 Action Plan.

In today's context of global tensions, in particular the Russian aggression in Ukraine, completing the CMU and strengthening the EU's financial sector is more necessary than ever. There are also numerous other reasons in favour of such a union. In the period of high inflation rates and unprecedented increase of energy prices, the CMU could become an effective solution for many of the challenges the EU is currently facing. Furthermore, it is also key to support the economic recovery from the COVID-19 crisis and to channel private funds into investments in the green and digital transitions and to build an inclusive and resilient economy.

Traditionally, the European Union has been a clear example of a highly bank-oriented economy where more than 70% of the corporate sector's external financing comes from banks.[2] Contrarily, obtaining funds from capital markets is the predominant financing method for the US business sector. As the previous economic crisis showed, relying largely on bank loans to finance major business activities is challenging when the economy is in turmoil. Therefore, COVID-19 and the further destabilising economic impact of the war in Ukraine, call for renewed urgency in developing strong and open European capital markets.

This paper sets out:

1. AmCham EU's vision for a strong and open CMU.
2. Our summary position on some of the key ongoing and upcoming CMU-related legislative proposals.
3. The significance of digital policy to the success of the CMU.

[1] 'Capital Markets Union 2.0: priority actions for functioning eco-systems – AmCham EU' March 2021, viewed June 2022. http://www.amchameu.eu/position-papers/capital-markets-union-20-priority-actions-functioning-eco-systems

[2] 'Financing the Europe of tomorrow'. *European Banking Federation.* September 2018, viewed June 2022. https://www.ebf.eu/wp-content/uploads/2018/09/Financing-the-Europe-of-tomorrow-a-vision-for-policymakers-banks-and-markets-in-a-changing-world-September-2018.pdf

Vision for the CMU

A strong CMU

In order to further unlock the potential of capital markets across Europe, continued efforts are needed to improve financing options for European companies, make the EU a safe place to invest in for the long-term and ensure greater integration of European capital markets by removing national barriers. Inconsistent Member State implementation of and approaches to supervision remain one of Europe's greatest challenges in building a stronger CMU.

AmCham EU therefore welcomes the Commission's proposals since November 2021 to review the Markets in Financial Instruments Regulation/MiFIR/D, the European Long-Term Investment Fund, the AIFMD and the CSDR as well as the ESAP proposal. Taken together, these frameworks will help further and better integrate capital markets, and will also help deliver on some of the key commitments of the 2020 CMU Action Plan. AmCham EU applauds the significant progress achieved under the French Presidency.

An open CMU

Openness to wholesale capital flows and market participants from both within and outside the EU – underpinned by cross-border regulatory and supervisory cooperation – will be a key driver of grow and will sustain efficient, effective and competitive capital markets in Europe. This openness can support the digital and climate change transitions and reduce the economic shock post COVID-19, compounded by Russia's invasion of Ukraine.

As such, the narrative on EU sovereignty (including for financial services) may have a counter-productive effect on the significant non-EU investor base currently invested in Europe as well as on the non-EU clearing services and liquidity providers. These providers currently contribute to much of the depth and growth of Europe's capital markets. The war in Ukraine calls for renewed transatlantic unity and global leadership in financial services policy, as has occurred in the trade and technology space through the EU-US Trade and Technology Council.

While acknowledging the legitimate need for some local adaptation, for wholesale capital markets that are fundamentally global, alignment to or definition of global standards increases the attractiveness of European capital markets and reduces the possibility of conflicts of law hampering growth.

Ongoing CMU-related legislative proposals

ESAP

AmCham EU supports the creation of an ESAP for corporate disclosure, as it increases the transparency, availability and timeliness of information, which enhances investor participation in financing European companies. The centralisation of corporate information can help unlock the potential of capital markets across Europe.

We agree with the overall approach that ESAP should not require the disclosure of additional information nor modify the content of existing disclosure requirements. In addition, ESAP should initially gather financial and non-financial information whose public disclosure is mandated through the Transparency and Annual Financial Statements Directives, the Prospectus and Taxonomy regulations as well as the upcoming CSRD.

The scope of the ESAP could then possibly be expanded to include other corporate disclosures, such as ‘material loan agreements’. The extension of the ESAP scope beyond these core company disclosure requirements should be based on an assessment of concrete use-cases for end investors.

A carefully calibrated timeline for implementation will be important, and AmCham EU supports a flexible approach.

AIFMD

The investment management industry plays a crucial role in meeting the CMU’s political aims: it helps pensioners and savers invest for a better future and it channels money into the economy supporting corporates, including small and medium-sized enterprises. Europe has developed the global gold standard brands of investment funds with the Undertakings for Collective Investment in Transferable Securities (UCITS) and AIFMD regulatory frameworks.

AmCham EU supports the European Commission’s targeted proposal on the AIFMD review, which recognises the fundamentally robust nature of the EU regime and notably, the benefits of the global practice of delegation. A key to continuing the EU fund model’s international success is its ability to access the best global expertise for investment activities across the world through delegation of portfolio management activities. These delegation practices are already underpinned by strong oversight, effective governance and a strict application of the EU rulebook for activities both in and outside of the EU.

While policymakers review the AIFMD framework, it is key to bear in mind existing provisions for substance as well as the effective oversight and control of delegation. Management companies already provide their national supervisors with extensive information on substance and quality of oversight. Any targeted revisions should focus on streamlining and reinforcing current practices, rather than creating duplicative or disjointed frameworks.

MiFIR/D

The CMU should promote policies that allow financial markets to maximise their role in funding the real economy. Behind a strong, more innovative and competitive CMU is market infrastructure, which promotes deep and liquid markets. COVID-19 has been a reminder of the fragility of market liquidity and of the importance of having efficient markets. A diversity of trading mechanisms must be encouraged to better handle adverse market conditions. Whilst reviewing MiFIR/D, policymakers should also continue to consider the different execution venues and the role that they each play in the wider ecosystem.

The MiFIR/D review can achieve this by continuing to support a wide diversity of trading mechanisms and recognising that a ‘one-size-fits-all’ market structure does not work well for all financial instruments and under all circumstances. Rather than focusing on pushing more trading on exchanges, as seems to be the intention of the recent proposals in the equities space, policy makers should focus on providing end investors with choices which in turn can optimise their trade execution, foster competition and drive down transaction costs. In the bond space, shortening the post-trade deferrals risks worsening market liquidity and prices for European investors when dealing with illiquid or large in scale transactions. Associated costs will be particularly felt for instruments where risk taking intermediation is a more important part of liquidity provision.

Whilst MiFIR/D may have fallen short of providing the expected transparency to the market, this is mainly due to the lack of data accessibility – the fragmentation of data across the different venues and Approved Publication Arrangements – as well as its lack of readability, as it is reported in different formats. The efforts should therefore focus on creating a Consolidated Tape for equities and bonds for smaller and retail investors, which will help increase their participation in EU markets. A Consolidated Tape for equities and bonds has the potential to significantly increase transparency by providing investors with a single and cohesive view of trading across the market.

CSDR

A crucial element of the CMU framework is the safety and efficiency of the arrangements required to finalise securities transactions. There is a clear flow in operations and interdependency between trading and post-trade processes, with efficiencies passing through from one to the other. The review of the CSDR, particularly the CSDR settlement discipline regime, is therefore a critical pre-condition for the development of capital markets in Europe.

In their current form, the CSDR settlement discipline rules, especially the mandatory buy-in regime, will reduce the efficiency of European capital markets, leading to greater costs, wider bid-offer spreads and less liquidity. They will act as a barrier for foreign investors in European securities and will encourage the transfer of capital markets activity outside of Europe. AmCham EU welcomes the narrowing of the scope of the mandatory buy-in (MBI) regime. However, it is not appropriate for any instrument type, and it is premature to introduce such measures until the effects of the cash penalties on reducing settlement fails have been assessed.

Instead, changing a buy-in from a mandatory obligation into a voluntary, optional right is the single most important rule modification that is needed. Also, a cash penalties regime should be prioritised as the most effective and transparent tool to encourage settlement efficiency, with a higher degree of data quality and of operational stability from the top of the holding chain.

Upcoming CMU-related legislative proposals

While the November 2021 package is a step in the right direction towards an open, dynamic and integrated EU-wide capital market, it is important to not lose sight of other crucial initiatives that are still in the legislative pipeline. The CMU project remains a long way from completion. Therefore, the Commission should deliver on its commitment to put forward other important legislative proposals in the coming months. The following actions are priorities for the immediate future.

Withholding tax

From a practical perspective, complex, inefficient and paper-based withholding tax procedures are the biggest barrier to cross-border investment in the EU. The COVID-19 crisis has demonstrated the vulnerability of current processes and the benefits of streamlined and digital processes from the perspective of both investors and tax authorities.

The objectives of Action 10, namely, a common, standardised, EU-wide system for withholding tax relief at source and allowing investors to provide one set of tax forms instead of 27 sets. These objectives are indispensable to building a true CMU and to attracting investment into European capital markets.

Listing rules for public markets

A vibrant and deep public equity market is the cornerstone of thriving capital markets. AmCham EU supports the Commission's plans to review existing listing rules by cutting the red tape for companies wanting to raise funds on EU public markets while preserving market integrity and investor protection.

Allowing for greater flexibility in the initial public offering (IPO) process is fundamental for this initiative's success. When choosing a location for the IPO, the biggest issue is the free float requirement – companies do not necessarily want to sell 25% at IPO. A move to a secondary market liquidity assessment should replace minimum percent free float requirements. By reducing the risk of execution, the proposal should allow for greater flexibility in the IPO process. The priorities for reform are: greater flexibility on the price range and deal size (including the removal of 48-hour withdrawal rights where the price or size change is not significantly altering the fundamentals [eg balance sheet] of the company post-IPO) and shortening the IPO timetable.

Securitisation

AmCham EU supports the Commission's intention to review the EU's securitisation framework. If developed to be responsible, prudentially sound and transparent, securitisation can be an important vehicle to increase the capacity of banks to lend and investors' access to European credit products by acting as a bridge between the Banking Union and the CMU.

While progress was made in the last Commission through the Securitisation Regulation, including the creation of 'Simple, Transparent, and Standardised' criteria, improvements can be made in areas such as increased certainty and transparency, prudential rules, synthetic securitisation, disclosures and third-country rules.

The European Commission should continue or begin work on a set of initiatives that are of great importance in the mid- to long-term, including the EU financial competence framework, the comparability of retail investment information, pension adequacy and harmonisation of non-bank insolvency laws.

The significance of digital policy to the success of the CMU

Digital technologies improve the processes of information collection, maintenance and transmission, which lie at the heart of financial markets. Accordingly, digital technologies can deliver major benefits for capital market participants and regulators. Not only can they improve traditional capital market processes, but they can also facilitate market access for existing and new market participants, such as retail investors and new types of issuer, thereby improving the size and quality of capital markets.

AmCham EU has welcomed the European Commission's digital finance strategy, which embraces digital finance for the good of consumers and businesses. We support the key priorities of this strategy, including (i) adapting the EU regulatory framework to facilitate digital innovation, (ii) establishing a common EU financial data space and (iii) ensuring a level playing field and the application of the principle of 'same activity, same risk, same rules'.

The Commission has issued several important proposals that directly relate to capital market activities, including a pilot regime for distributed ledger technology (DLT) market infrastructures, a horizontal framework for crypto assets including Stablecoins in the Markets in Crypto-assets Regulation (MiCA) and a specific cybersecurity resilience regime for financial services in the Digital Operational Resilience Act. The ESAP proposal is also important, as it helps create the foundations for a common EU capital markets data space.

AmCham EU welcomes these proposals but also wishes to stress that the European legislators and regulators need to ensure that these specific texts sit within a broader framework that encourages digital innovation. For this, they should considering the following aspects:

- One important current gap relates to the legal foundations for digital assets and digital processes. An adequate legal framework must recognise the rights associated with the ownership of digital assets, both at national and cross-border levels. Some Member States have taken important initiatives, but there is the risk that Europe will develop 27 separate and incompatible national regimes. In future years, a difficult and complex European legislative process might be needed to make the regimes compatible.

- Legislative proposals creating pan-European regulatory frameworks for digital assets and processes should be compatible with a diversity of market models, especially since there is no certainty as to how market models will evolve. For example, MiCA lacks an appropriate liability regime that allows investors to use the custodians' services to hold digital assets and permits custodians to provide such services. Thus, public authorities should provide a clear path for the transition from the temporary pilot regime for DLT market infrastructures to a more definitive regime.

- Many innovative projects, including those using DLT, need the ability to use a safe cash asset. It is important that the EU legal, regulatory and supervisory frameworks facilitate the use of such assets. One form of such an asset would be a central bank digital currency (CBDC) that would be available to both wholesale and retail market participants. In the absence of such a CBDC, it is critical that market participants have access to deposit tokens that represent deposits at central banks or at commercial banks.

- A fourth category of requirements for a broader framework for digital innovation relates to interoperability and the use of standards. The integration and optimisation of complex processes involving multiple parties requires common definitions, protocols and standards. Interoperability is needed to avoid the risk of market segmentation.

- A fifth, but just as important, category relates to the CMU and single market agenda. A digital environment and a digital market are not isolated from existing legal, regulatory and fiscal rules, and from existing markets and market infrastructure. The lack of progress on the CMU handicaps the development not only of traditional capital markets in Europe but also of new, innovative and digital markets.

It would be a major failure if the development of digital markets in Europe and of infrastructure based on DLT replicates the inefficiencies and market segmentation that arise out of different, and in many cases, inefficient national processes and requirements.