Financial Conduct Authority

The Financial Conduct Authority's response to the European Commission Green Paper: *Building a Capital Markets Union*

Introduction

We welcome the Commission's initiative to develop a Capital Markets Union (CMU). The CMU goals of growth and stability through deepening capital markets, enhancing investor choice, and diversifying financing opportunities for companies beyond bank finance, are valuable aims that the Financial Conduct Authority (FCA) strongly supports. Our response is therefore intended to support the development of CMU. In it, we set out overarching perspectives which we believe are critical to enable the development of CMU to be as effective as possible. We also set out actions which we believe should be important elements of the CMU action plan.

Although EU capital markets have developed over recent decades we agree that fragmentation persists with a strong national bias and a smaller pool of funding available for investment in the EU than in the US[1]. In addition, many EU domestic capital markets lack scale or competitiveness compared to the US[2]. Completing the single market in capital and breaking down barriers to cross-border capital flows will help diversify risk, create larger economies of scale and thereby enable more efficient allocation of capital.

This will require action to: a) increase the supply of investor finance into capital markets; b) ensure competitive, fair and effective intermediation at a proportionate cost; and c) facilitate increased use of capital market finance by corporates and others. These three elements are inextricably linked. The Commission's aim can only be achieved by a programme which focuses on all three elements. Our suggested actions are therefore structured around these.

We look forward to opportunities to work with the Commission as it develops further specific initiatives and proposals to deliver its CMU Action Plan.

OVERARCHING PERSPECTIVES

1. Greater supply of investor finance will require appropriate investor protection.

Investors putting their money into capital markets rather than bank deposits bear more risks and make more investment decisions. Investors therefore need appropriate investor protection. We think there is no trade-off between measures to promote market access and investor protection; rather, they go hand in hand.

Investors will be more likely to invest if the product is explained adequately, they are confident that the product is appropriate to their needs and risk appetite, and they trust that the product has the necessary safeguards and is provided within a robust but proportionate regulatory framework. Measures which achieve this clarity, confidence and trust should help increase the supply of investor finance into capital markets.

2. Focus on effective implementation of existing and already planned legislation

There is already a substantial body of legislation promoting a single capital market in Europe. The main building blocks are already in place. These include:

- Measures to protect the needs and interests of investors in such areas as prospectus information, information for investors on packaged retail products (PRIIPS),

[1] http://www.bankofengland.co.uk/research/Documents/fspapers/fs_paper33.pdf
[2] http://www.ceps.eu/publications/which-union-europe%E2%80%99s-capital-markets

distribution rules (e.g. in MiFID 2, IMD II and the UCITS Directives) and redress and compensation mechanisms.

- Initiatives to promote and develop elements of the single market in capital by harmonising trading and post-trading rules and strengthening transparency (MiFID 2/MiFIR, EMIR and CSDR).

Many of these measures are still in the process of being finalised and have yet to be fully implemented. The key remaining components, in many instances, are the level 2 standards. Completing this work and implementation must be a priority, and doing so should move a significant way towards achieving the fundamental aims of CMU.

3. More consistent supervision within the current framework could bring significant benefits

The functioning of integrated capital markets requires consistent application and supervision of the single rule book across Member States. This is central to maximising the efficiency of supervision within the single market. It is important that supervisors have largely equivalent powers in supervision, investigation and enforcement, and a willingness to use them to ensure that consumers and markets benefit from an equivalent level of protection.

The ESAs provide the mechanism and the forums to promote effective and consistent supervisory standards and outcomes throughout the EU, working in close co-operation with NCAs. The ESAs should use the full set of their existing convergence powers to ensure compliance with the agreed rule book and comparability of supervisory outcomes.

4. Legislate only where necessary and embed the Better Regulation agenda

The EU Better Regulation approach should underpin the completion of the existing legislative program and new initiatives. High quality legislation that ensures market integrity, efficiency, financial stability and investor protection in an effective but proportionate way is essential to attract EU and third country capital. Reviewing and re-calibrating existing regulation should continue to be a priority, and new legislation should only be proposed when it is necessary.

In line with the principles of subsidiarity and proportionality, we welcome the Commission's approach which allows for market-led and national solutions where appropriate. Furthermore, an undue focus on institutional issues or unwarranted legislation initiatives could impede the timely delivery of the CMU agenda.

5. Embrace the opportunities of new technology and the potential gains from effective competition.

Actions to facilitate 'digitalisation' to respond to investor preferences and give investors greater control over their investments should be encouraged. The growth of mobile access to information through tablets and smartphones continues to shape the consumer experience. Digitalisation provides an opportunity to improve the engagement between investors and investment product providers, increase financial awareness, give consumers greater control over their investments, and drive down costs in capital markets. That said, it also provides a range of challenges for EU regulators: particularly around security, data protection, investor protection and maintaining fair competition, which need to be addressed.

Competition is at the heart of efficient, open, and resilient economies and must be at the heart of a successful CMU. Competitive markets are characterised by features such as low barriers to entry, expansion and exit, rivalry between firms, and high levels of customer engagement. Competitive markets establish the right incentives for firms, help deliver the best outcomes for consumers, and result in lower prices and higher levels of service and innovation (such as

digitalisation). We would encourage all EU institutions (including the ESAs) to ensure that the drafting of level 1 and level 2 rules promotes competition. As the Commission will know, the FCA is developing its use of market studies as an element of its competition remit, to assess whether competition in identified sectors is working efficiently – and has launched a market study into investment and corporate banking. We believe that such work will inform both national and wider policymaking in these markets.

6. European markets need to be embedded in a globally competitive landscape

Steps to attract capital should not be limited to the EU. Actions should be taken to ensure that the EU is an internationally competitive and attractive place to invest. The Commission should ensure that EU legislation as far as possible is aligned with wider global standards. Where internationally agreed standards exist, the EU should follow these when drafting legislative proposals. We also believe a set of principles should be developed to ensure that third country access regimes are proportionate and effective – we set out our suggestions in our detailed response to the Green Paper questions.

PRIORITIES FOR ACTION

We set out below a number of actions which we believe should be important elements of the CMU Action Plan. These are developed in our later answers. As a general point, we would note that ahead of developing a new legislative programme, the Commission should review existing legislation and areas where rules are yet to be finalised, to ensure that they are consistent with the CMU objectives.

Enhancing the supply of investor finance

1. Ensuring investor protection

a. As already stated, the Commission should focus on finalising and ensuring consistent implementation of key dossiers such as MiFID 2, PRIIPS, IMD, PSD and funds rules.

b. Consideration should also be given to whether some elements in these frameworks could be extended; for example, we believe the MiFID 2 product governance requirements should be applied to a wider range of products, including insurance, lending and credit products.

c. To support confident investing, the Commission should consider progressing its earlier ideas to create an EU Insurance Guarantee Scheme framework and consider reintroducing an updated Investor Compensation Scheme Directive.

d. Industry should be encouraged to make investment processes simpler and more transparent, where possible. The FCA is currently working with the UK industry to develop better ways for firms to communicate with customers. We will be publishing a discussion paper on this and will share these ideas with the Commission and other stakeholders.

e. Increasing financial capability will help investors to understand capital markets better, the opportunities and risks, and could thus encourage participation. The Commission

should support Member States in designing investor education programmes to build capabilities.

2. ***Harnessing the benefits of digitalisation***

a. The creation of EU level product/price comparison websites could enable consumers to compare different cross border investment options. While such initiatives should be predominantly market-led, the Commission could engage with industry and regulators to encourage their development in a way that delivers beneficial outcomes and protects investors' interests.

b. In the UK, there is current interest in ideas such as 'account aggregation' and the idea of a 'digital passport' or portable electronic customer profile. These aim to speed up the process of opening investment accounts for consumers and establishing advisory relationships, and to help consumers to access and manage their finances in one place online. National authorities should engage with industry and others to ensure that such ideas are developed in a way that protects investors' interests and in full compliance with regulatory requirements.

c. More broadly, we support the Commission's focus on creating a Digital Single Market and believe that the Commission should also examine whether the current EU legislative framework adequately accommodates digital channels used by providers and consumers, and the kinds of digital innovations mentioned above. We would, for example, encourage a movement away from the predominant model of paper-based disclosure regimes which have underpinned the development of many European disclosure requirements (e.g. the provision of KIDs in PRIIPs and KIIDs in UCITS). Communication and disclosure models should accommodate a range of channels and formats to match consumer preferences. The FCA is already seeking to embed these considerations into its own regulatory approach.

3. ***Competitive, fair and effective intermediation***

a. Steps should be taken to ensure that appropriate pooled investment funds are available for a variety of different investors. This should include consideration of whether, with the creation of a passport under AIFMD, there is a migration of certain types of strategies and funds from the UCITS to the AIFMD framework. If so, this development could allow for a simplification of the scope of eligible investments allowed under the UCITS umbrella, which could in turn encourage further retail investor participation.

b. We believe there should be increased transparency in extra requirements for marketing of funds on a cross-border basis in each Member State, and a common format for disclosing such extra requirements. This would create extra predictability and certainty for fund managers and help them manage their costs.

c. Existing EU legislation should also be reviewed to encourage more participants and greater competition in the funds sector. For example, we support steps to revise the Regulations to allow larger EU fund managers to run EuVECA and EuSEF funds, and believe this would be beneficial to the uptake of these funds. Investing via a EuVECA could also be made more attractive by widening what qualifies as an eligible investment.

d. The Commission should ensure that there is consistency between different EU sectoral regimes, where possible, including in the drafting of level 2 requirements. For example, we strongly support the case for consistent selling practices between MiFID 2 and IMD 2, as far as substitutable investment products are concerned; in addition, the UCITS brand would benefit from consistency with MIFID 2 cost transparency requirements.

e. Where possible, and where it does not adversely impact investor protection, the Commission should explore opportunities to reduce the cost of intermediation, as such costs are ultimately born by investors. For example, the content of prospectuses for equity issuers with shares already admitted to trading on a regulated market undertaking a debt issue could be reduced to focus on the additional information debt investors will need. Another example is issuance programmes which are currently renewed annually through the publication of a new base prospectus. The disclosure could be streamlined so that the revised documentation focuses on updates and changes.

Demand for capital

4. Reviewing the Prospectus Directive

a. CMU should give consideration to the Prospectus Directive being re-worked to focus on a single purpose: the admission of securities to the stock market. The Prospectus Directive's other function, the regulation of public offerings of unquoted securities, could be dealt with in other EU regulation more suited and adapted to that different purpose.

b. We also believe there would be value in reforming public offer arrangements. In particular, we believe that having securities admitted to a regulated market should carry with it a right to make public offerings of those securities across the single market. Under this model, issuers are not offering into any one jurisdiction; they are offering into the entire single market at once and issuers do not have to conduct 'due diligence' on all jurisdictions.

5. Examining impediments to bond market liquidity

a. We encourage the Commission to initiate a comprehensive, evidence-based study into corporate bond market liquidity. This should also take account of other international work being carried out in this area, including by the FSB and ESMA. It should also involve a quantitative/empirical data gathering exercise in addition to a detailed examination of market microstructure and the collection of qualitative analysis from market participants. The FCA can provide expert technical advice to the Commission in this matter as well as help facilitate the collection of market data and intelligence.

6. Improving available credit information

a. We believe that it is essential to improve available corporate credit information, and Member States should ensure that there is a level playing field between bank lenders and non-bank lenders in respect of access to credit information. The Commission should provide technical assistance where necessary.

b. We would also support the Commission issuing a recommendation on common minimum standards for the SME credit information that should be made available through the reporting infrastructure of each Member State, alongside a timetable for Member States to progress at national level.

CONCLUSION

The FCA welcomes the Commission's work on CMU. It is a long term project and the FCA stands ready to provide technical support to help the Commission develop and deliver its Action Plan for implementing CMU.

ADDITIONAL RESPONSES TO SPECIFIC GREEN PAPER QUESTIONS

Q1: Beyond the five priority areas identified for short term action, what other areas should be prioritised?

Please see our covering narrative for our views on additional areas which we believe should be prioritised, and specific suggestions for short term action.

Q2: 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?

The development of a common minimum set of comparable credit information that could be disclosed to interested parties would facilitate the efficiency and integration of SME funding markets. We would suggest the Commission issue a recommendation on common minimum standards for the SME credit information with a timetable for Member States to progress at national level. However, individual Member States should be left to decide how to meet these minimum standards (e.g. through the establishment of a public credit register or through greater use of private credit bureaus). EU Legislation is not appropriate or necessary as there are varied methods of information provision, variety of providers (both publicly-owned and private) and different legal systems across Member States. For example, the UK's *Small Business, Enterprises and Employment Act 2015*, makes provision for improved access to finance for businesses and individuals. The Act includes measures to improve access to SME credit data by ensuring that this is shared through Credit Reference Agencies.

We would also support an extension of the work done by the ECB and Bank of England on 'loan level templates', and by ESMA on ABS disclosure requirements to help improve data availability and standardisation. The Commission should also ensure its data protection rules (including under the current review of the EU regime) do not hamper the ability of credit registers and private credit bureaux to provide relevant information on SMEs.

Q3: What support can be given to ELTIFs to encourage their take up?

The regulation has only recently been published in the Official Journal and it is too early to judge the potential success of ELTIFs. However, we believe the Commission and Member States should ensure there is a level playing field between bank lenders and non-bank lenders in respect of access to credit information. The current environment creates a disincentive for asset managers who would be interested in managing ELTIF funds because it does not allow them to access information required to make an informed risk-based decision on investment opportunities. Digital channels can serve as a useful way of accessing this information. Care must also be taken by the institutions and ESAs to ensure that work on other sectorial legislation and ELTIF level 2 standards helps ensure a level playing field for ELTIFs.

Q4: 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?

The FCA supports the development of a more vibrant private placement market, provided that adequate care is taken to address any investor protection issues and to ensure that any conflicts of interest are properly managed. For example, where an investment firm is providing advice to an issuer client on the pricing or allocation of an offering, that firm's primary duty is to the issuer client, though there can be powerful commercial incentives for firms to favour their own interests or the interests of influential investors.

Our understanding is that a key factor to fostering private placement markets is ensuring that private bond markets have the same withholding tax treatment as regulated market issuers. We observe that the current effect of tax legislation is that many issuers opt-in to listing, and with it the Prospectus Directive, in order to achieve a favourable tax treatment.

Q5: What further measures could help to increase access to funding and channelling of funds to those who need them?

We believe this can be aided by reworking the Prospectus Directive to focus on a single purpose: the admission of securities to the stock market. The Prospectus Directive's role would be to form one of a suite of tools designed to make Europe's regulated markets function better and achieve their purpose of matching enterprises that need finance with investors that want investment opportunities. The Prospectus Directive's other function, the regulation of public offerings of unquoted securities, could be dealt with in other EU regulation more suited and adapted to the very different issues and purposes they pose.

This should be done concurrently with a review of the arrangements around public offering. While the Prospectus Directive gives issuers the right to offer their securities across the European Union, in practice issuers do not use those rights very much. Where issuers make a public offering under the Directive they tend to restrict offerings to select jurisdictions. This is not just because they have to go through the Prospectus Directive passporting procedure and so translate the prospectus summary of their prospectus, but also because it is not cost effective to undertake due diligence in a smaller jurisdiction unless there is sufficient demand there. This means that investors in these countries do not have the opportunity to participate fully in the single market and issuers are not able to source the whole European market.

Two major changes to the public offering arrangements should be considered:

- First, having securities admitted to a regulated market should carry with it a right to make public offerings of those securities across the single market. This would also apply to initial public offerings where the offer would not complete without admission occurring. Prospectuses would only be triggered when an issuer requests admission to trading on a regulated market.
- Second, when a regulated market issuer makes a public offering of securities, that offer, and any resultant bargains struck between issuer and investors under it, should be deemed to be occurring in the jurisdiction where the stock market is located.

Under this system, issuers are therefore not 'offering into' any one jurisdiction but rather offering into the entire European single market. As well as creating a genuine European single market, this addresses the points we make above about issuers having to do due diligence in all jurisdictions.

This revised system is clearer, intuitive and simpler. Treaty rights of citizens will be protected as general EU principles on equal treatment of citizens will apply: it will be the responsibility of the authorities in the Member State where the stock market is located to protect all investors equally, irrespective of where they come from. Other benefits include:

- The responsibilities of regulators in various Member States would be re-aligned with the expectations of the public.
- The need for a passporting mechanism is dispensed with under this system.
- Retail cascades would no longer need to be provided for in the Prospectus Directive.
- Large offers of in-issue shares which are already admitted to trading could be offered to the public without a prospectus.

We have set out more detail on these ideas in our response to the Prospectus Directive review.

Q6: 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.

Additional investment could be attracted by increasing liquidity and encouraging more investible assets. This should be subject to a number of considerations. Firstly, standards should not be weakened in an effort to attract new issuers. Secondly, issuers appreciate the flexibility that bonds offer and so tend to want to issue bespoke products, tailored to their financing needs and demand in the primary market. But investors, in particular those with a liquidity preference, might be better served by more standardised products which are more amenable to trading and more likely to be liquid. There is no clear solution to these challenges and trade-offs, but work to address them should be undertaken. For example:

- Policy makers should seek the views of potential new entrants – both buy-side and sell-side – and be mindful to attach the appropriate weight to the views of incumbents.
- Policy makers should seek a market structure that does not assume investors are of a uniform type and should challenge structures that segment capital.
- Policy makers should prioritise the identification and elimination of impediments to liquidity.

We encourage the Commission to initiate a comprehensive, evidence-based study into corporate bond market liquidity to identify whether there are any impediments restricting liquidity and which may warrant further intervention. Two examples are:

- **High denomination bonds:** The dual-standard for disclosure in bond prospectuses contained in the existing Prospectus Directive requires more disclosure for issuers of bonds with a denomination per unit below €100,000 than bonds above €100,000. This creates an incentive for issuers to issue bonds in denominations above €100,000, which could be a significant impediment to liquidity, and should be eliminated.
- **Tranche size:** Market practice is that bond issuers issue numerous tranches of similar products, which can silo liquidity. Consideration could be given to incentives to issue follow-on tranches of bonds fungible with bonds already in issue, perhaps through the removal of any significant documentation on the issue of a follow-on tranche.

Work in this area should take account of other international work being carried out in this area, including by the FSB and ESMA. It should also involve a quantitative/empirical data gathering exercise in addition to a detailed examination of market microstructure and the collection of qualitative analysis from market participants. The FCA would be happy to contribute to such work, and help facilitate the collection of market data and intelligence.

It is also important to consider that there is already a wide array of new market initiatives in place aimed at improving secondary market liquidity. In particular, there are many new electronic trading venues that have launched in recent years. The 'electronification' of bond trading may help by making it more practicable, quicker and cheaper to reach a wider and more diverse market than is possible with over-the-counter or voice-driven dealer markets. This is especially the case with small- and mid-sized trades, where the majority of emerging electronic trading networks are currently gaining market share.

With regards to standardisation, the search for liquidity-enhancing improvements to secondary markets could start with primary markets. Issuers of fixed income securities could have a role to play, although secondary market liquidity will not always be a priority for the issuer; in fact, in our many discussions with issuers they have stressed their greatest need is for flexibility, for example to fund a specific investment project with specific financing terms or to access the market at a particular time.

Various other ideas have been put forward with the aim of enhancing liquidity in corporate bond markets, and the FCA is in the early stages of exploring some of these while gathering more information. We will share these findings with the Commission. Key issues include increasing retail participation in bond markets, making the allocation of initial issues more transparent or open to a wider number and larger range of participants, enhancing pre- and post-trade transparency, and making small but important changes to the Prospectus Directive.

Q7: 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?

We believe that Member State and Commission support of industry-led initiatives to standardised disclosures, templates and guidelines is the right policy response at this stage. This will promote further transparency and better comparability for investors. For example, the rapid growth in the market for green bonds has prompted considerable efforts by market participants and others to develop guidelines. As well as the work of the World Bank, the European Investment Bank and the European Bank for Reconstruction and Development, initiatives such as ICMA's development of Green Bond Principles are notable.

It is also important to ensure that ESG data sets can be compared easily by investment managers as they make investment decisions for end-investors. Poor data accessibility can lead to poor decision making. Financial information has increased the amount of ESG data available but it is currently not standardised and there would be value in industry led efforts to standardise this data.

Q8: 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?

Convergence in accounting standards brings benefits in consistency and comparability across issuers and markets, and this has been evident since the introduction of IFRS on regulated markets. We believe that there could be much to be gained from exploring the possibility of aligning current national accounting standards already used on various trading venues with IFRS. We recommend that accounting standards are considered further as CMU is developed, and that the appropriate accounting bodies are fully engaged in discussions.

However, we do not consider that a mandatory common EU level accounting standard for SMEs admitted to SME Growth Markets (or MTFs) is required, even if such a standard were available. It would be preferable to allow operators of SME Growth Markets some flexibility in the accounting standards they require for the issuers on their markets. This is consistent with the approach we support for operators of SME Growth Markets within the context of MiFID 2.

Q9: Are there barriers to the development of appropriately regulated crowd-funding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

Independent research[3] shows that the UK market for regulated investment-based and loan-based crowdfunding has been growing rapidly in recent years. Nevertheless, the crowd funding market is likely to remain a small part of overall funding for corporates, and may not be appropriate for all types of investors. The entities raising finance often include start-up or young businesses and the risks of full capital loss can be pronounced. Many ordinary retail investors will struggle to assess the risks involved and may not be able to afford the potential losses. In developing the UK's regulatory framework for crowd funding we have sought to balance investor protection needs with the development of a proportionate, competitive digital fund-raising market. In addition, the FCA is already working with ESMA and the EBA to share our experience of regulating the growing UK market, and we remain in contact with the Commission on this.

EBA and ESMA[4] recently published opinions with regard to the regulation of crowdfunding. These suggest that, as the sector is at an early stage in its development, it should be allowed to develop within the parameters of existing EU legislation and supported by rules introduced at national level. They also suggest, however, that gaps in the existing EU

[3] http://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf
[4] https://www.eba.europa.eu/documents/10180/983359/EBA-Op-2015-03+(EBA+Opinion+on+lending+based+Crowdfunding).pdf
http://www.esma.europa.eu/system/files/2014-1560_advice_on_investment-based_crowdfunding.pdf

framework should be considered and assessed. We believe this is the correct approach at this time.

It is already possible for some crowdfunding platforms to conduct cross-border transactions – using passports in directives such as MiFID, the freedoms provided for in the E-commerce Directive, or under the AIFMD. We consider that the currently limited numbers of cross-border transactions are more likely to result from other factors rather than regulatory restrictions. The industry is nascent, but once it becomes more established, with platforms establishing a sound track record, we would expect them to engage in more cross-border activity and to attract greater cross-border investor interest.

Q11: 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?

The creation of passporting rights under AIFMD, UCITS, and new product regulations such as EuSEF, EuVECA, and ELTIF has aimed to facilitate the marketing of funds on a cross-border basis by fund managers. Some national regulators have imposed further requirements on top of those in the level 1 directive (covering fees, paying agents obligations etc). However, these extra requirements can create legal uncertainty for fund managers, as well as increase costs, if they are not readily known, which in turn may discourage fund managers from marketing in other jurisdictions. To the extent that such requirements are imposed, they should be justified and there should be increased transparency in extra requirements in each Member State and a common format for disclosing them.

In addition, we would encourage supervisory convergence in fund supervision, and national regulators should adopt a consistent approach to ensure that fund managers do not incur extra, unplanned costs. ESMA should play a part in this via the creation of a supervisory forum to examine the requirements placed on fund managers and the reasoning behind them with the aim of facilitating a more consistent approach.

Q13: Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

The UK has a well-developed pensions system (both occupational and personal) with over £2 trillion assets under management. Domestically, the UK focus has primarily been on meeting the challenge of an ageing population. This has included the introduction of auto enrolment for workplace pensions and more freedom in how retirees use their pensions pot. These UK reforms should support the objectives of CMU in the long term by increasing the overall quantity of assets under management and by giving investors control over their investment needs. If coupled with efforts to increase financial literacy this could lead to more investors' choosing to invest in capital markets.

As part of this, UK consumers already have a wide choice of personal pension products provided by a broad range of providers from across the EEA. We do not believe that there are regulatory barriers to the establishment of cross-border firms. The lack of uptake may simply be a result of a lack of demand and challenging long term obstacles in the form of differing social, labour and tax law. Pensions products provided through a 29th regime would, for example, struggle to compete with domestic products which benefit from incentives such as

tax relief. Introducing a parallel regime could also actually increase complexity for investors and lead to regime shopping, with providers opting for the least onerous regime, possibly leaving investors less protected than they might have expected.

We are working with EIOPA on advice to the European Commission on the development of the single market for personal pensions, including consideration of the 29th regime. This is due to be returned to the Commission in February 2016 and this advice should help the Commission determine whether further actions are needed.

Q14: 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?

We support the Commission's view that revising the Regulations to allow larger EU fund managers to run EuVECA and EuSEF funds would be beneficial to the uptake of these funds. At the moment, the EuVECA and EuSEF regimes are only available to AIFMD sub-threshold firms, who are not always able to take up such opportunities due to the costs involved in running the funds. The threshold for participation and restrictions in the range of assets available for investment in EuVECA could also be considered. A requirement for investors to invest €100,000 per fund is a very high hurdle and would prevent even sophisticated investors from being able to diversify their holdings.

The eligible assets requirements should be reconsidered and made more flexible to help increase uptake of these funds. For example, the SME definition (target companies in which EuVeCa are allowed to invest) which is currently based on number of employees may exclude companies which have more than 250 employees but are, from a financing perspective, still at an early stage. Also the use of debt instruments alongside equity instruments could provide more flexibility in the early finance stage and should be considered.

Q18: How can the ESAs further contribute to ensuring consumer and investor protection?

The ESAs have a very important investor protection role to play, and we welcome the explicit recognition of this in each ESA's mandate. We think that the existing mandates are sufficient, and what is required is that the ESAs continue to develop and strengthen their structures, forums and outputs in order to deliver on the mandates. We do not see a need for further new ESA mandates or powers in this space.

Much of what the ESAs have achieved in this area has clearly been in response to the level 2 mandates they have received from the Commission under specific legislation. They have collectively delivered a significant level 2 programme of advice and draft standards (e.g. under MiFID, PRIIPs, IMD, MCD, PSD and others), harnessing the expertise of their members and market participants (including consumer representatives). This activity will inevitably continue to be one of the main strands in their work to ensure consumer and investor protection.

But there are other ways in which the ESAs have contributed in this area. Much of their non-legislative work is focused on consumer protection - and also complementary to the aims of CMU. Examples of this are each ESA's work on market monitoring, monitoring of consumer trends (and issues such trends raise), their consideration of financial innovations, the ESA

Consumer Days and Investor Education Days, their advice to the Commission on crowdfunding and the recently launched work on issues around automated advice. These are all examples that demonstrate the key role that the ESAs (with their members) can and do play.

However, within the existing mandates, there is scope to develop and refine some of these activities and for better coordination between the ESAs in delivering their mandates. One particular element that might also be developed further is interaction with consumer representatives – specific sections within consultations setting out issues of most relevance to consumer and consumer groups could help harness their input. In addition, impact assessments could include sections specifically designed to measure the impact legislation and standards would have on consumers.

While the ESAs have a key part to play, so of course do national authorities. Effective distribution policies, for example, require national and EU initiatives to work in tandem. Product distribution rules are the cornerstone of legislation such as MiFID, IMD and the Mortgage Credit Directive (MCD). National authorities also play a valuable role by intervening to protect ordinary retail investors from 'non-mainstream', higher risk investments. For example, the FCA introduced requirements on the retail distribution of "non-readily realisable" securities (including unlisted SME securities and mini-bonds), "non-mainstream pooled investments" (including types of AIF) and, more recently, CoCos. Member States should ensure National Competent Authorities (NCAs) have adequate consumer protection mandates and powers to deliver effective investor protection.

Q19: What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

Participation by investors in scale will largely come through pooled investment vehicles. If we want to encourage investors to move their savings from bank deposits to capital markets we need to recognise that they will be exposed to greater and different types of risks. There is a place for direct retail participation in capital markets, but experience suggests that ordinary retail investors will need significant protections which will limit the scale of their participation in these channels (e.g.. crowdfunding). Nevertheless, policy measures which focus on a) improving investor understanding, confidence and trust in capital markets, b) increasing investor access to capital markets, and c) ensuring there are appropriate vehicles in a competitive market place to channel investments could increase participation. We welcome the opportunity to work further with the Commission on embedding these considerations.

Improving investor understanding, confidence and trust in capital markets

Three actions should be undertaken to improve investor confidence and trust in capital markets.

1. The Commission should consider whether product governance requirements, like those set out in the MiFID 2 package, should be applied more broadly. Work is already underway at both the EBA and EIOPA developing sectoral guidelines with a view to promoting consistency between the non-MiFID banking and insurance sectors. Negotiations on the revised IMD are currently underway and we expect that requirements on product governance for manufacturers and distributors will be included there too. We also believe product governance standards should feature in future banking legislation to cover other lending and credit products.
2. Transparent costs are a key foundation of trust. The Commission has increased transparency requirements in several measures, including MIFID 2 and in PRIIPs, notably

with regard to cost and charges disclosure; we believe the UCITS brand would benefit from achieving greater consistency with PRIIPS and MIFID 2 requirements in this area.

3. We believe that the absence of a pan-EU insurance guarantee scheme framework is a gap in the EU single market consumer protection architecture, given the existence of both the Investor Compensation Schemes Directive and the Deposit Guarantee Schemes Directive. The Commission should also review its recent decision to withdraw its 2010 proposal to revise the Investor Compensation Scheme Directive. As long as some of the previous more contentious elements of the revision were reconsidered (e.g. pre-funding and risk-based levies), we think there are single market and investor protection benefits to be gained from a strengthened and updated minimum standards EU ICSD regime, and that this would further help level the playing field between capital market investments and bank deposits.

Three particular actions should be undertaken to improve investor understanding of capital market products:

1. The PRIIPs and UCITS key investor information requirements go a considerable way to ensuring that consumers receive appropriate product information. The Commission should focus on consistent implementation of these rules and ensuring consistency between these different legislative requirements, the MIFID requirements, and the new investor information proposals in dossiers such as IORP II.
2. NCAs should work with industry to improve disclosure models. The FCA, for example, is working with the UK industry to develop better ways to communicate with consumers on products and services. We will be publishing a discussion paper and will share these findings with the Commission.
3. The Commission should support Member States in designing investor education programmes to build financial capabilities. This is an integral part of empowering EU citizens to access and use capital markets effectively and responsibly. The UK is currently developing a Financial Capability Strategy to coordinate and prioritise work to improve this. The final Strategy will put in place an action plan, with commitments from organisations to take specific steps over the next few years to advance the cause of greater financial capability in the UK. It will be published in September 2015 and we will share the findings with the European Commission. The UK's Money Advice Service report on "Money Lives"[5] also provides detailed information on investors' behaviours which may help inform approaches to building financial capability.

Increasing investor access to capital markets

Digitalisation offers a promising opportunity to increase investor access and should be encouraged. While many initiatives will be market-led, we support consideration of the following three particular actions:

1. National markets have seen the development of websites which enable consumers to compare different investment products. These websites have not only helped consumers in making choices but have also led to pressure on providers to reduce costs. But progress at an EU level has been uneven. While these should be market-led, the Commission (and the ESAs) could engage with industry and regulators to encourage their development. In doing so, it will need to be mindful of the investor protection issues that such platforms and tools may create (including potential conflicts of interest) and we welcome the opportunity to engage with the Commission in the light of our experience of such websites.

[5] https://www.moneyadviceservice.org.uk/en/corporate/money-lives

2. In the UK, there is current interest in such innovations as 'account aggregation' and the idea of a 'digital passport' or portable electronic customer profile. Such ideas aim to speed up the process of opening investment accounts for consumers and establishing advisory relationships, and to help consumers to access and manage their finances in one place online. National authorities should engage with industry and others to ensure these are developed in a way that protects investors' interests and in full compliance with regulatory requirements.
3. More widely, we also support the Commission's focus on creating a Digital Single Market. As part of such work, we believe that the Commission should examine whether the current legislative framework adequately accommodates the use of digital channels by providers and consumers. We would, for example, encourage a movement away from the model of a paper-based disclosure regime which has underpinned the thinking behind the development of many European disclosure requirements (e.g. the provision of KIDs in PRIIPs and KIIDs in UCITS). In this respect, we welcome the flexibility embedded in MiFID 2 which allows national regulators to explore different ways for firms to disclose information.

The FCA is already seeking to factor in such considerations to its own regulatory approach and we welcome the chance to provide technical advice to the Commission on these considerations. For example, we are:

- Working with the industry and other stakeholders to consider whether our current regime adequately accommodates new technologies and innovations (notably the FCA's "Project Innovate" initiative)[6];
- Providing guidance to firms on how our requirements apply when social media are being used (e.g. in respect of advertising and disclosure);
- Considering the issues around automated advice channels at both national level and with the ESAs; and
- Considering broader issues of 'smarter communications' with investors across the full range of modern communication channels.

Ensuring there are appropriate vehicles to channel investments

The UCITS brand has developed extensively since the first 'eligible assets' directive. In recent years, more complex funds (i.e. AIFs) may have rebranded as UCITS, pushing the limit of what is permitted under the eligible assets rules in an attempt to benefit from a cross-border marketing passport. More complex instruments and strategies may be more suitable investments in the new ELTIF framework and in AIFMD. We believe the Commission should analyse whether with the creation of a passport under AIFMD may lead to the natural 'simplification' of strategies under UCITS. This review should also consider whether simpler products could encourage further retail investment in the UCITS brand. Once such an analysis is conducted, the European Commission should consider reviewing the scope of eligible assets UCITS can invest in.

Q20: Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

We are supportive of firms seeking to develop less complex products that can offer better value for money. There have been several attempts to encourage the development of simple retail investment products in the UK. These include the development of a suite of "Stakeholder

[6] http://www.fca.org.uk/firms/firm-types/project-innovate

Products" (and, associated with that, the concept of 'Basic Advice') and the 'Sargent Review' of Simple Financial Products.[7]

However, both initiatives illustrated the challenges faced in seeking to develop such products - particularly around weak consumer demand for specific simple investment products and a commercially unattractive market for firms when margins are small. They show that regulatory barriers did not act as an impediment to product development. Moreover, one of the lessons of the Sargent Review is that this is not necessarily a short-term response. The review was begun in 2011 and the first simple products were launched in 2014. Furthermore, none of these products were investment products.

Q21: Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?

Creating an open capital market is central to the CMU goals of growth and stability:

- Internationally competitive, well-functioning capital markets facilitate greater risk sharing across countries, by enhancing financial integration and reducing the reliance of the EU economy on EU funding.
- Open capital markets benefit firms by giving them access to funds that originate outside the EU.
- Firms that operate internationally are able to carry out their activities globally, allowing a better allocation of resources.
- Households in the EU will be able to invest internationally and so diversify their portfolios. This reduces income volatility and gives household access to products that better match their preferences and, in certain cases, at lower prices.

Financial integration and well-functioning financial markets can also of course increase the growth rate of economies. In the longer run compounding means this effect can be extremely powerful.

Three particular actions should be taken to help ensure that the EU is an internationally competitive and attractive place to invest:

- Ensuring that EU legislation follows better regulation principles;
- Following international standards where possible; and
- Developing a set of principles to ensure that third country access regimes are proportionate, consistent and effective.

In terms of how to promote open capital markets, good regulation that ensures market integrity, efficiency, financial stability and investor protection in a proportionate fashion will attract external capital. Implementing the Better Regulation agenda is thus an important element. We therefore support the Commission appointment of a first Vice-President with particular responsibility for Better Regulation. The Better Regulation lens must be applied to all measures enacted as part of the CMU programme - with a particular focus on their impact on growth and competitiveness, to contribute to the jobs and growth objective. The EU must also focus on ensuring that agreed legislation is implemented effectively; with breaches of EU

[7] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/191721/sergeant_review_simple_products_final_report.pdf

obligations, such as late or incomplete implementation, reviewed and addressed on a consistent basis across the EU.

International bodies, such as the FSB and ISOCO, play an important role in setting the standards for global markets. Where international agreed standards exist, the EU should follow these when drafting legislative proposals. Where the Commission deviates from international standards, this should be identified and justified in the impact assessment.

Where an effective third country access regime is necessary the FCA believes that a set of principles should be developed to ensure that these regimes are proportionate and effective.

The most common third country approach used in European legislation involves assessments of equivalence. The benefits of this are that financial actors seeking access are not subjected to dual or conflicting regulation; that markets and actors in the Union are protected against prudential, financial stability or investor risks; and it incentivises other jurisdictions to adopt comparable legislation or implement international standards. However, equivalence regimes in legislation are not always clear (for example, it is not always clear that the assessment is *outcomes* based) or applied on a consistent basis.

But equivalence is not the only access model used in EU legislation and proposals. The Credit Rating Agencies Regulation[8] permits third country entities access to the Union if they are endorsed by a European CRA and comply with particular requirements that are equivalent to the regulation. MIFID and AIFMD do not impose a third country regime for "passive marketing"[9]. Therefore, while equivalence is the prevalent method for granting access, it is not necessarily the only, or the most effective approach; and in developing proposals we believe that more consideration should be given to these alternatives rather than automatically adopting an equivalence approach.

Consequently, to ensure that third country regimes in legislative proposals are effective, consistent and proportionate, a set of principles or "modules" should be developed to govern the drafting of third country access regimes in EU legislation. We would suggest the following 8 principles merit consideration:

1. **Follow International Standards**: Where international agreed standards exist, the EU should follow these when drafting legislative proposals. Deviations should be minimised and where they are necessary they should be identified in any proposal and justified in the impact assessment.
2. **Access regime only where justified**: as a matter of Better Regulation, the starting point in developing any proposal should be that an access regime should only be inserted where justified (rather than the automatic insertion of an equivalence regime). While in many cases an equivalence regime will be justified, this principle seeks to ensure that other potentially more proportionate approaches are considered.
3. **Consistent and Proportionate Equivalence regimes:** where an equivalence regime is justified, it should be tailored to the risk it mitigates (such as prudential, financial stability, investor protection). It should also be clearly stated in any legislation that the equivalence assessment is outcomes based.
4. **Modular Approach where necessary:** different access regimes should be applied to different parts of the services the legislation covers, depending on the different risks access poses, and in light of the principles of proportionality and subsidiarity. For example, MiFID has different regimes for wholesale, retail and CCP access, to reflect different investor

[8] Article 4(3) of the Regulation (EU) No 513/2011
[9] Article 4.1 (x) AIFMD, MIFIR Recital (43) MIFID 2 Recital (111) Article 42

protection and prudential risks each poses, in order to ensure proportionate access regimes that respect the principle of subsidiarity.

5. **Subsidiarity:** third country regimes should respect the principle of subsidiarity. Where justified, national regimes should be permitted (e.g. MiFID 2 Article 39 retail regime) either in substitution for or as an alternative to equivalence regimes.
6. **Additional or alternative regimes:** additional or alternative access regimes (e.g. endorsement, national regimes or application of EU law) should always be considered. In particular, where EU legislation does not implement (or goes beyond) international standards, alternative approaches to equivalence should always be included to avoid closing EU markets.
7. **Appropriate Transitional Provisions:** third country regimes should always include transitional provisions to ensure proportionality and in recognition of the fact that different jurisdictions will implement international standards at different times. Until such time as equivalence is granted, national regimes should govern access.
8. **Forward looking, taking account of the digital agenda:** third country regimes should not be designed just to accommodate financial services as they exist today, but should also facilitate future developments; in particular they should be drafted to be applicable to the digital or electronic provision of financial services and not unjustifiably discriminate against this mode of provision.

Q22: What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?

The access of EU firms to third countries can equally be facilitated by applying the measures we outlined in question 21; Better Regulation, following international standards, and applying fair, effective and proportionate third country regimes, will all facilitate the access of EU firms to investors and capital markets in third countries.

Ensuring that EU financial legislation is good legislation through the application of the Better Regulation principles is a key step. If EU firms are well regulated, it helps their competitiveness and makes them better placed to invest in third countries. Moreover, the application of good legislation by the EU can encourage other jurisdictions to adopt similar legislation or adopt a facilitative approach to firms subject to this legislation. The Commission work to attract third country domiciles for UCITS is a good example of how this approach can be applied. But more can be done, both in respect of UCITS and in building on this experience in other areas.

If EU regulation follows international standards, then this is likely to facilitate the entry of EU firms into those third countries that apply these standards, whether access is governed by equivalence, deference, mutual recognition or the application of national regimes. Moreover the consistent application by the EU of international standards in its legislation should encourage others to do likewise.

Q25: 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?

The functioning of integrated capital markets requires consistent application and supervision of the single rule book across the different Member States. This is central to maximising the efficiency of supervision within the single market. It is important that supervisors have largely

equivalent powers in supervision, investigation and enforcement, and a willingness to use them to ensure that consumers and markets benefit from an equivalent level of protection.

The ESAs provide the mechanism and the forums to promote effective and consistent supervisory outcomes throughout the EU, working in close co-operation with NCAs. The ESA Regulations recognise this and give them a wide range of convergence powers to deliver on this mandate. We do not believe that the ESAs require new powers in this area and they should focus on using the full set of their existing convergence powers in a proportionate, practical and effective way to achieve their objectives. But they should also explore new ways of bringing supervisors together to exchange experience and share practices, and to address practical common issues, challenges and problems, with a view to seeking agreed consistent solutions.

Although the intensity of their initiatives varies to some extent (partly because of their different histories), all the ESAs have already undertaken significant work in this area; through measures to create common understandings (Questions and Answers, Data Collection and Supervisory Training), common practices (Guidelines, Opinions and Supervisory briefings) and Peer Reviews of NCAs supervisory practices. In our view, this provides a good basis for development.

The ESAs, like all public authorities, have limited resources and will need to make choices on where to concentrate their supervisory efforts. While continuing to carry out peer reviews, we believe that maximum value will be achieved by a greater emphasis on identifying, supporting and sharing good practices and effective supervisory techniques. NCAs can use this to refine and improve existing supervisory practices, tailoring approaches to the particular features of their jurisdictions. ESMA's new crowdfunding supervisory forum is an excellent example of how this can potentially work in practice (and ESMA has other similar existing fora which could be developed further). Current discussions in the ESAs around approaches to product governance, market monitoring and the use of product intervention powers are also examples of where practical supervisory debates promote effective and consistent outcomes.

The ESAs also have the power to a) investigate where the NCAs have not applied the relevant legislation (or have applied it in a way which appears to be a breach of EU law) b) carry out binding mediation (in cases identified in sectoral legislation) to assist NCAs in settling disagreements that have arisen on breach of Union law incidents and c) carry out non-binding mediation in any area that falls within the authority's scope of activities. We believe it is important that the ESAs are willing and able to use their full supervisory convergence toolkits.

Notwithstanding our comments, however, it is also vital to recognise and accommodate inevitable differences in market, product and investor characteristics and behaviours. And effective conduct supervision must be done by national regulators who are expert in the day to day operations of the entities and markets they oversee and have proximity to the markets they supervise.

Q26: Taking into account past experiences, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets with the EU?

The Central Securities Depositories Regulation (CSDR) was an attempt to create a common market for securities settlement. However legal barriers still limit freedom of issuance and free flow of securities across borders. Overcoming these 'Giovannini' barriers should continue to be

a focus. Much work is currently underway which should be built on, including the Geneva Securities Convention (UNIDROIT) and the Hague Securities Convention.

Harmonisation of securities law is a complex issue to address but the Commission should begin to lay the foundations for future work in this area. This should include steps to harmonise rules on settlement finality outside Settlement Finality Directive (SFD) designated systems. The EU Institutions should also finalise the revised EU Shareholder Rights Directive in a way that delivers clear improvements to shareholder engagement while avoiding unjustified costs or inefficiencies.

Q28: 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 is a significant body of EU cross-sectoral company law and specific corporate governance standards in the EU financial services legislation. This is generally appropriate and necessary.

However, we are not convinced that the current balance between EU and national company law frameworks creates significant obstacles to the capital markets – except in specific areas we have highlighted elsewhere in this response. Within the current legal framework, we believe that corporate governance is best left to national jurisdictions - provided that the outcome in each is that there is sound governance and robust shareholder protection. Excessive harmonisation carries a risk that a 'one size fits all' approach is adopted which will reduce shareholder protection or fail to recognise particular national features (such as the extent of formal employee participation in some countries, or the UK's developing financial services framework for senior management responsibility and accountability). What robust shareholder protection involves in any one jurisdiction will depend on underlying company law, corporate and market structures and the nature of the shareholder base.

The European Commission's recommendation on the quality of corporate governance reporting (the 'comply or explain' principle) (2014/208/EU) recognises the concept of 'comply or explain' as a mechanism which can be used successfully throughout Europe. 'Comply or explain' assists companies in how they report and help investors better to understand the companies in which they invest. Departing from a code provision using 'comply or explain' provides companies with flexibility by allowing them to adapt their corporate governance to their size, stage of development, shareholding structure or business sector. We support proposals which will support the spirit and practice of the Commission's Recommendation and promotes a culture of accountability, encouraging companies to disclose their corporate governance arrangements. 'Comply or explain' is now widely supported by companies, investors and regulators throughout the EU as an appropriate tool to promote good corporate governance.