THE EUROPEAN CAPITAL MARKETS UNION: AN INVESTOR PERSPECTIVE

FEBRUARY 2015

Introduction

The Capital Markets Union project was announced in July 2014 by EU Commission President Juncker as part of his five-year agenda, and is currently being defined as an actionable framework. In its political ambition, it seeks to remove barriers to the free flow of capital in Europe, and increase the role that market-based finance plays in intermediating capital to European companies, projects and governments.

The economic recovery in Europe has been hampered by an overreliance on bank finance. Banking regulation – fundamentally necessary from a financial stability perspective – has combined with market conditions to constrain bank lending considerably. Without a deep source of non-bank finance, Europe has seen weak credit growth. Whilst bank finance is likely to continue to play a dominant role in Europe, particularly in financing certain segments, increasing the role that market finance plays in the European economy can diversify the sources, and potentially drive down the cost, of funding to the benefit of European companies and investment projects.

But for Europe to unlock this potential, a regulatory framework that attracts private capital needs to be put in place.

While definitions of what specific components might constitute a Capital Markets Union vary, we believe that, first and foremost, Europe must create a single capital market that works in the interest of its main beneficiaries: 'asset owners', that is, investors spanning from individual savers to institutions such as pension funds and insurers that invest on their behalf; and companies, infrastructure and other projects investing in the so-called 'real economy'. On this premise, we look at how both investors and companies currently interact with the market and assess whether improvements can be made to allow each greater ease of entry, and to create new opportunities to connect investors' capital and real economy sectors that need investment.

More broadly, policymakers need to incentivise both savers/investors and companies to participate in a reformed capital market. For a company, the greatest incentive is generally a lower cost of funding. The picture is more complex for savers and investors as they have varying liabilities, investment objectives and regulatory constraints. Generally, however, they have to feel confident to commit their savings in the capital markets. The more investor centric the regulation, the greater the potential flows of capital that savers will be willing to invest to both their own and the economy's benefit.

This should be the starting point for policymakers: putting 'Capital' into the 'Capital Markets Union'.

In this *ViewPoint*, we set out our thinking in the areas we believe are fundamental to the success of the Capital Markets Union. We explore areas in which increased investor interest and participation could help to drive down the cost of funding for companies and projects. From this analysis we make recommendations likely to result in savers and investors committing their capital to such companies and projects. Many of the recommendations in our roadmap will be met by pieces of legislation that are either in the implementation phase, or currently under discussion – however, there are some areas where targeted further action from policymakers could be impactful.

Asset owners and asset managers

Asset owners can manage their money directly and/or outsource this function to asset managers. Asset owners include individuals, pension funds, insurers, sovereign wealth funds, foundations, endowments and family offices. In this *ViewPoint*, we refer to asset owners in this paper also as 'savers', 'investors' or 'institutional investors' (when referring specifically to institutions such as pension funds or insurers).

Asset managers act as agent on behalf of their clients, the asset owner. Asset managers are required to act as a fiduciary and invest according to the investment guidelines set out in the legal documentation of the mandate set out, or the product selected, by the asset owner.

Top 5 new policy recommendations

1. 'Digital investment passport' and minimum standards of financial guidance to democratise advice and guidance to European savers
2. Study on standardisation of certain aspects of corporate bond issues over €500m
3. Consistent, investor-centric, securitisation framework and appropriate risk weights in prudential rules
4. 'Asset passport' that would level the playing field between bank and non-bank private finance to encourage the take up of ELTIFs
5. Creating a market for investment in bank whole loans to increase the availability of bank capital for lending

Types of asset owners

Individual retail investors, referenced as savers, encompass a broad range of investor types with very different savings needs: for example, those saving for a home purchase or for their retirement and those seeking to generate investment income. As a result, their investment objectives, risk tolerances and investment horizons vary widely and will often change dramatically over an individual's lifetime.

Pension funds encompass defined benefit (DB) and defined contribution (DC) pension schemes sponsored by public entities and corporations. Over the past twenty years, there has been a significant shift into 'alternative' investments such as real estate, private equity, and hedge funds as well as a liability-driven shift into (longer duration) fixed income.

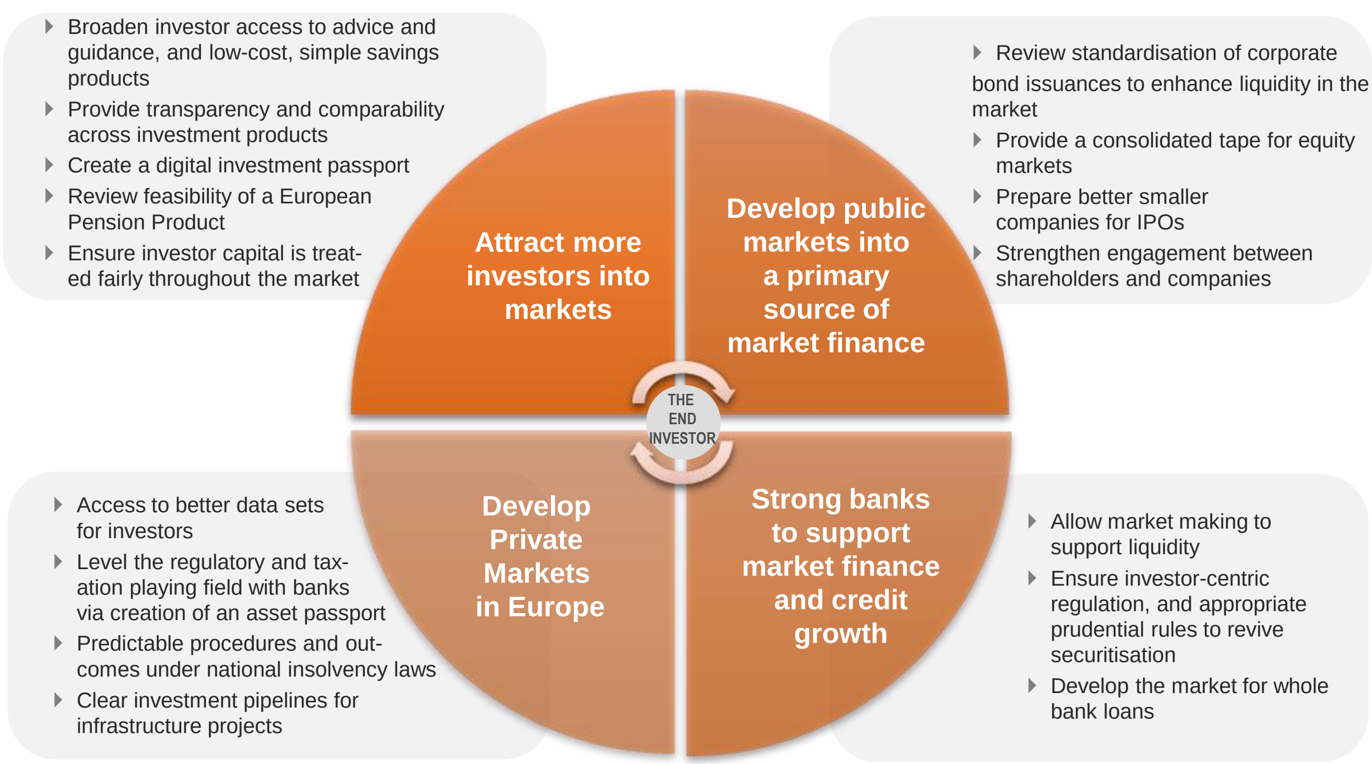
Insurance companies cover a wide range of different business models with specific products from which they project their liabilities. While individual company portfolios differ significantly, the asset allocation of a typical insurance company is heavily weighted towards high-quality fixed income securities.

Official institutions include sovereign wealth funds, central banks, and other financial entities controlled by a national government or governments. They are not a homogenous group with respect to governance, asset allocation, investment horizons, or transparency, and are not subject to the same regulatory or accounting rules that apply to other asset owners.

Banks are among the largest asset owners in the world, in aggregate. They invest in a broad range of assets – typically holding wholesale and retail loan exposures such as commercial real estate loans, syndicated loans to large companies, small business loans, unsecured credit card receivables, home mortgages and more.

Individual retail investors appear above as a single type of asset owner but in reality the individual is the ultimate beneficiary behind many of the segments above, as a member of a pension fund or insurance policy or as a tax payer.

AN INVESTOR-CENTRIC ROADMAP TO A CAPITAL MARKETS UNION



Summary of recommendations

To maximise the efficiency of the Capital Markets Union – in terms of potential benefits to both savers and the economy – we recommend concentrating efforts on the areas that are likely to offer the most up front benefit to the economy while laying the groundwork for longer-term structural changes.

1. As an overarching priority, policymakers should focus on encouraging and enabling Europeans to save more effectively. The focus has to be on equipping savers with the tools to achieve their income goals in retirement. For those in work, this means making effective use of income today to generate sufficient income tomorrow. Too much of Europe's savings is held in a way that does not allow it be intermediated into the real economy. This hurts both our savers, who in many cases are not achieving financial independence in their retirement, and our companies, which have fewer funding sources available to them. We recommend the following actions designed to give citizens the confidence to invest to achieve their future income goals:

- Supporting savers with a new framework for advice and guidance to ensure that they have access to the tools and support to help them save more constructively. This requires a minimum standard of impartial financial guidance and consistent standards of qualification for financial advisers and investment guidance **(NEW POLICY)**
- Providing savers with meaningful transparency and comparability across all investment products. and enhancing the quality of service they receive through increased focus on suitability and product governance (implementation)
- Enabling technology to facilitate guidance and advice and simplify the savings process for the wider population. For example, a 'digital investment passport' would make advice accessible to broader segments of savers **(NEW POLICY)**
- Further democratising savings through the development of low-cost, simple, easy-to-access products which provide solutions to meet individuals' savings and retirement income needs (industry)
- Reviewing demand for, feasibility and key features of a cross-border personal pension vehicle as a means of empowering consumers to save more effectively for their retirement needs (EC review)
- And, perhaps most fundamentally, **ensuring that investor protection is not just a point-of-sale principle, but that savers and their capital are treated fairly throughout financial markets, from benchmark submissions to CCP recovery and resolution** (implementation)

2. As a funding source for companies, we believe that public markets are likely to offer the most significant, and immediate, economic benefits. However, to play this role more effectively, reform is necessary. Debt issuance is, for the moment, one of the main sources of funding for many European companies, and so the creation of a stable, well-functioning European bond market is fundamental to a Capital Markets Union. We believe that:

- Standardising some elements of large bond issuances (over €500m), along with expanded e-trading, and new trading protocols could deliver greater secondary market liquidity, and help to reduce the cost of funding for a wider range of European companies (EC review)
- Delivering a consolidated tape for equity markets in Europe is a critical part of driving down the cost of capital for companies (implementation)
- Better preparing smaller companies for IPOs would reduce costs for issuers and put investors in a better position to assess investment opportunities, in particular by simplifying procedures for issuing prospectuses and by removing unnecessary disclosures (EC review)
- Strengthening the engagement between equity investors and companies through agreement of the Shareholder Rights Directive with particular focus on cross-border voting and related party transactions (implementation).

3. We see considerable merit in looking for ways in which capital markets can help banks to clear room on balance sheets and so encourage new lending. European banks, because of their strong national networks and information on historical performance and credit histories, will always be best placed to be the first point of contact for certain types of borrowers in Europe, specifically small and medium-sized companies. In the medium-term, we believe:

- Reviving securitisation – by creating an investor-centric, consistent and streamlined regulatory framework and recalibrating Solvency II risk weightings – would put banks in a position to lend more **(NEW POLICY)**
- As could developing a European market for investment in bank whole loans by transforming bank loan assets into 'security-like instruments' **(NEW POLICY)**

Top 5 barriers to a Capital Markets Union

1. Lack of access to investment advice and guidance, and products to allow individuals to save effectively
2. Poor liquidity in corporate bond secondary markets
3. Poor data transparency for non-banks in certain markets coupled with lack of standardisation of prospectuses and processes
4. National regulation which discriminates against market finance such as withholding tax on loans or national insolvency laws
5. National taxation that distorts flow of capital in Europe (e.g. in favour of one channel over another)

4. Although we see valuable incremental growth in the medium term, achieving appreciable scale in private credit markets in Europe is a longer-term challenge.
The traditional dominance of banks in lending and project financing has resulted in both significant barriers to market finance as well as in the underdevelopment of some of the key investor requirements for investment in scale. While many of the barriers to growth in this area are politically challenging to remove, the long-term payoff in terms of growth and funding opportunities could be significant. Across the broad range of private credit asset classes, the key factors that could help to grow the market over the longer term are:

- Access to comprehensive and consistent data sets on investment opportunities and performance histories **(NEW INITIATIVE)**
- Standardisation of documents and processes to help to lower operational costs to institutional investors, thereby reducing the cost of capital to companies and projects (industry)
- Removal of national barriers which discriminate against capital markets investors in favour of bank based investors, such as withholding tax on loans or preference given to banks during insolvency proceedings through a 29th regime 'asset passport'. This will be key to the success of the ELTIF as an effective cross-border investment vehicle **(NEW POLICY)**
- More broadly, while aligning national insolvency regimes is a long-term goal, a valuable first stage would be for Member States to commit to predictable procedures and outcomes under national insolvency laws **(NEW INITIATIVE)**
- Clear investment pipelines to reinforce investor confidence in relevant asset classes: the EFSI project pipeline for infrastructure has the potential to address this (implementation)

As an overarching point, we believe that the Capital Markets Union reforms should ensure that Europe has a coherent, stable and investor-centric regulatory framework that will reinforce investor confidence. Ideally, regulatory, accounting and tax rules would be aligned to facilitate the allocation of capital to long-term asset classes like infrastructure, renewable energy and securitisations. It is important that asset owners are encouraged to make these allocations through appropriate prudential treatment for long-term assets (for insurers, banks and pension funds), and the right incentives (e.g. investment eligibility and appropriate tax treatment) to invest.

Top 5 policy initiatives undermining a Capital Markets Union

1. MiFID 'investor protection' regime could potentially reduce the availability of quality investment advice and guidance
2. Solvency II risk-weighting calibrations are significant barriers to investment for insurers in long-term assets
3. FTT will discourage investment and significantly reduce certain public market instruments
4. Base Erosion and Profit Shifting (BEPS) will discourage cross-border investment into funds, especially those investing in real assets
5. National differentiated voting rights rules discriminate against cross-border shareholders

STEP ONE:
Attract more investors into the markets

For capital markets to play the long-term role that policymakers envisage in supporting the European economy, they will need to grow considerably. A fundamental challenge, therefore, in creating a Capital Markets Union, will be increasing the pool of European savings available to be put to use via capital markets.

In some countries, the savings rate is too low, and policymakers may need to find ways to encourage citizens to start saving more. But in most European countries savings rates are relatively high and these existing savings need to put to more effective use.

Both aspects are fundamental: increasingly, European citizens are being forced to be more responsible for funding their own retirements; and savings that are held in cash, bank deposits, or assets like 'bricks and mortar" are not put to use channelling funding into the real economy. We need also to recognise that the digital economy will fundamentally reshape the savings process in coming years and empower citizens to make more effective decisions to meet their long-term savings needs.

The solution is a roadmap that puts investors at the heart of our policy discussions around a Capital Markets Union in Europe – one that not only addresses the issue of encouraging more savings, but also provides an environment where those savings are put to good use. A Capital Markets Union can create a framework where Europeans feel secure and confident in putting their savings to productive use in capital markets **by providing meaningful access to investment advice or guidance that helps them save constructively, enabling new technology to help in the process, opening up a wider range of easy-to-understand products that can be bought through an execution-only service, and ensuring that investor capital is treated fairly whilst invested in capital markets.**

BlackRock's 2014 Investor Pulse survey interviewed 11,000 European savers to understand their approach to saving and investing.[1] The key conclusions that, we believe, the Capital Markets Union must address are:

- More than half of all household assets across Europe are held in cash. For the benefit of both savers and our economy alike, these assets need to be put to more productive use.
- Professional investment advice is one of the fundamental elements which drive investor confidence and their willingness to invest.
- Efforts to encourage the take up of financial advice and guidance are needed to give Europeans the tools they need to make effective retirement planning decisions. Despite clear benefits, only about half of Europeans have ever sought help from a professional.

Investment advice and guidance

To ensure that individuals have access to an effective means to save, Europe needs a model for financial advice and guidance which works for broad segments of society. **Europeans who use a professional adviser are significantly more likely to be positive about their future, feel more in control and more confident about financial decision-making, and as a consequence, more likely to invest in financial markets.** However, according to BlackRock's Investor Pulse survey, fewer than 1 in 5 Europeans actually use the service of a professional adviser, often due to issues around cost. Increasingly, when looking for professional help in making investment decisions, investors are stuck between costly, full-service investment planning and advice, and a 'do-it-yourself' execution-only service which does not provide the tools many people need to navigate the complexities of the choices they face. To attract more investors into markets, this artificial divide needs to be addressed – by defining minimum standards for guidance and by leveraging technology, so making saving accessible to wider segments of European citizens.

What's the difference between advice and guidance?

The current European regulatory framework has a multi-level definition of what constitutes 'investment advice'. In summary, it requires advisers to make a personalised recommendation to buy or sell a specific financial product or products.[2]

We use the term 'guidance' to cover the wide variety of advisory models such as generic, simplified or automated advice which do not constitute a personalised recommendation on a specific product. Individual savers who do not want or do not feel able to afford full investment advice increasingly require more guidance on their savings than can be provided by execution only services.

Regulators such as the UK's Financial Conduct Authority acknowledge that there is currently a perception of regulatory risk when providing guidance which has the effect of stifling the type of innovation which would benefit savers.[3] Defining minimum standards for guidance would accelerate such innovation.

When finalising MiFID II – both at Level 2 and in national implementation – we need to ensure that we have understood the consequences of moving away from a distribution system that is funded in large part by product providers via commissions or retrocessions, to one where savers bear the costs of obtaining needed advice and guidance directly through paying an upfront fee. **The impact of this change will be different in each national market – but across Europe, the new system must not make professional advice unattainable for large segments of citizens. First and foremost, the average investor should be better off than they were under the previous system. This means delivering the very real benefits promised by MiFID and Packaged Retail and Insurance-based Investment. Products (PRIIPs) in terms of suitability, product governance, enhanced service provision and cost disclosures.**

Additionally, we recommend that policymakers consider:

- A minimum standard of impartial financial guidance could help investors understand where to begin. Many savers will benefit from entry-level guidance provided to tight standards agreed between industry, consumer bodies and regulators to allow them to put a savings plan in place.
- Financial guidance and workplace advice provided by impartial or non-industry bodies could have a valuable role in education and helping consumers on how to save. The financial services industry will need to work with government and consumer organisations to design standards for unbiased guidance and the means to make to it accessible.
- Consistent standards of qualification or training for financial advisers and for investment guidance across Europe to ensure the integrity of the system.

Transparency and comparability

To facilitate trust, investors need meaningful comparability and transparency across both investment products and their distribution. PRIIPs, UCITS, MiFID and Insurance Mediation Directive / Insurance Distribution Directive (IMD / IDD) have the potential to deliver this. Level 2 will be key in making sure Europe achieves this. The final result will need to ensure all participants in the product distribution chain consistently act in the interest of savers. Disclosure standards for all investment products need to be consistent and show all the elements that contribute to the costs and risks of investing to allow a meaningful comparison of investment options. This will be challenging, but is ultimately necessary to deliver investor protection which empowers consumers and drives greater cross-border competition. Enhanced suitability requirements should not just be a box-ticking exercise, but focus attention on designing solutions that meet an individual's savings needs.

Harnessing technology to improve access

Technology can be used to empower savers to take greater control over their savings and drive down the cost of giving advice and to enhance the saver's experience. We believe that partnership between industry, governments and regulators on new ways of using technology could yield real benefits. In order to deliver this for the next generation of consumers, a Capital Markets Union can apply advances from the creation of a connected Digital Single Market in Europe.

The development of a 'digital passport' could make the process of savings easier, by allowing multiple stakeholders such as product manufacturers, distributors, agents, advisers and government departments all to work with savers using a common platform and common data. Given the very real concerns about the use of personal data, it is essential to put the saver at the centre of the digital passport, with full control over who has access to their data. While consumers could have real concerns about unauthorised access to their data, these can be addressed by the harmonisation of European data protection rules as part of a truly connected Digital Single Market.

A digital passport should lead to a single identification and fact finds for an individual consumer. At the moment, fact finds have to be completed by each provider and for each product. This currently takes too much of an individual's consultation time and therefore the cost of advice, which is leading many distributors to restrict personalised advice to the few. If a fact find could be completed once and validated by a single provider, this would allow the consumer to open an account or purchase an investment service with more providers with the benefits of a single log in and a consolidated view of their savings. Use of technology in this way would go a long way to ensuring that the benefits of advice and guidance are available to broader segments of savers.

Increasing the availability of easy to understand products

Consumers will only benefit from technological innovations if savings solutions are made relevant to them. Distributors and product providers are increasingly drawing lessons from behavioural finance to design simple savings solutions that explain the benefits of investment to consumers who may be unfamiliar with saving other than through bank deposits. In the future, we believe many savers will want to access savings solutions through digital platforms or advisory services with the backup of telephone support which can help validate their choices, rather than meeting with advisers for personalised advice. We recommend that future legislation and regulatory guidance in this area fully assesses the complexity of consumer behaviour to avoid unintended outcomes.

Product manufacturers also need to play their role in developing products that are designed to be sold without full service advice. As a product provider, BlackRock believes there are an increasing number of products which have the potential to trigger greater 'democratisation' of market participation. These include low-cost and understandable multi-asset product solutions which provide active asset allocation and use index-tracking funds and Exchange-Traded Funds (ETFs) as their component building blocks. These products give retail investors greater ease of access to investment opportunities that might have been unavailable to them, or at least only at a higher cost.

Assessing the opportunity for European Personal Pensions (EPP)

Studies have shown a causal link between the size of pension fund markets, capital markets and GDP growth.[4] Equally, simple, cost-effective personal pensions can play a key role in developing a savings culture and allowing individual savers to prepare for their retirement. Having said this, a number of factors have to be in place for a European personal pension to be successful. We therefore recommend a careful consideration of the following issues:

- **Demand** – will sufficient demand exist to allow an EPP to operate at scale and provide low-cost solutions? A number of larger Member States already have comprehensive, tax-advantaged, national private pension coverage. Demand for an EPP is therefore likely to be higher from smaller Member States where there is currently no or limited access to retirement savings vehicles.
- **Distribution** – which distribution channels will unlock most demand in these countries? Incorporating an EPP into workplace solutions provided by employers may be more effective than distributing an EPP by more traditional distribution channels. This would reinforce the need for simple, low-cost solutions to act as the default investment option provided by the employer.
- **Transparency and disclosure** – how best to give savers the tools to compare EPPs and contrast their value with other savings vehicles? Pensions are currently excluded from PRIIPs but savers will need equivalent levels of transparency and disclosure as with other investment products if they invest in an EPP.
- **Administration** – how best to leverage parallel EU initiatives to simplify tax reporting at a European level? Treaty Relief and Compliance Enhancement (TRACE), Common Reporting Standard (CRS) and other initiatives could be leveraged to establish a common reporting standard and significantly reduce the cost of tax compliance. Similarly, the use of a single or a minimal number of central administrative platforms to settle deals and provide member reporting would keep costs down.
- **Settlement** – how best to deliver cost-effective solutions whilst meeting national specificities? The greater the number of variants, for example different currency exposures, the more expensive a cross border EPP will be. A common settlement hub could potentially address this and encourage portability if an individual changes currency zone.
- **Taxation** – the significance of tax barriers will vary from state to state. In some Member States, access to previously inaccessible investment solutions might outweigh the lack of specific tax benefits of an EPP.
- Finally, we recommend that any future Commission assessment incorporates findings from national behavioural finance studies to ensure the design of any EPP facilitates rather than hinders distribution and delivers scalable low cost solutions which deliver predictable outcomes to the majority of pension savers.

Treating investors fairly throughout the market

Beyond the accessibility of a constructive means to save, the framework of a Capital Markets Union must restore investor confidence that their capital will be treated fairly and efficiently throughout the market. Beyond bank reform, the second greatest focus of the post-crisis agenda has been market structure and conduct reforms. This is imperative to ensuring that investor protection is not just a point of sale principle, but that investor capital is protected as it moves through the market. To achieve this principle, we must deliver two key points on the forward policy agenda:

- The international and EU focus on benchmark regulation must address both conduct and integrity issues in critical benchmarks such as LIBOR or EURIBOR. **This is imperative so that that investors have confidence that the market is fair, and not skewed against their favour. This means rules that address conflicts of interest and transparency around the submission process.**
- Financial stability is an important concern for investors, and much of the post-crisis reforms enacted globally have the potential to greatly increase the resilience of the financial system, and therefore, investor confidence in financial markets. But as new rules require widespread mandatory use of certain types of market infrastructures – such as central clearing counterparties (CCPs) – investor interests must be meaningfully represented and fairly treated to maintain this confidence. While we are supportive of the concept of central clearing to reduce counterparty risk, we are concerned that the risks are being concentrated in CCPs. We encourage measures to reduce the likelihood of a CCP failure, protecting investors, and avoiding the contagion effect of such failure. These include: robust capital standards for CCPs; rigorous stress testing of CCPs; transparency of risk management practices to counter-parties of the CCP; and identifying a resolution plan, including a clear waterfall, in the event of a CCP

failure which returns client margins in a timely and orderly way. **Were European regulation to permit the haircutting of an investor's variation margin to recover a CCP, this would be counterproductive. It would be both highly pro-cyclical and at the same time fail Europe's pensioners and savers. Regulation will have mandated them to use CCPs whose failure would put them in a worse situation than in the prior bilateral world.**

STEP TWO:
Develop public markets into a primary source of market finance

BlackRock believes that enhancing the efficiency of public markets offers the greatest potential return in terms of funding opportunities for European companies. Ensuring that the markets are structured in a way that provides liquidity – especially in fixed income – will be critical in establishing a firm foundation for a Capital Markets Union, creating greater funding opportunities and attracting and maintaining the confidence of a broader range of investors in capital markets. While considerable reform has been agreed for equity markets (but must be secured fully in implementation), fixed income markets are in need of greater scrutiny.

An investor's view of liquidity

Liquidity – that is, a market that is deep enough to sell an investment in normal market conditions in a reasonable amount of time and at or near the actual value of the asset – is a key determinant in how investors allocate their capital. Investors prefer, and are generally prepared, to pay a premium for liquidity. Retail investors are generally less equipped to predict future liquidity needs than institutional investors. Hence they are relatively more concerned about the liquidity in their funds to meet unpredictable liabilities (e.g. sickness and unemployment).

An illiquid investment can be like a lobster pot: easy to get into, but difficult to crawl out of. The more illiquid the asset, the greater the expected rate of return must be to warrant an investor buying and holding the asset. Even with greater potential returns, investors will limit the amount of illiquidity they are exposed to.

In the context of a CMU, facilitating liquidity is key. Where the project opens up new markets, or where existing markets are enabled to play a greater role in financing the economy, liquidity will be a fundamental consideration. Investors typically consider the liquidity of their overall portfolio, with larger allocations made to liquid assets classes. If the more 'liquid' asset classes, such as corporate bonds, prove to be illiquid, this is likely to reduce allocation to the more illiquid asset classes (infrastructure, renewable energy and social housing).

Fixed income market reform

A stable, well-functioning bond market is a critical tool to provide capital to issuers and investment opportunities to a broad array of savers and investors. It should be a central element of the Capital Markets Union project.

Currently, there isn't such a thing as a European corporate bond market. Fragmented and typically bilateral trading presents material barriers to integration, and the inevitable complexity and inefficiency arising from this could manifest itself as a cost to European companies and investors. New issue practices have contributed to a market structure that is inherently illiquid. Companies tend to issue bonds whenever financing needs arise or opportunities present themselves. As a result, trading and liquidity is fragmented across thousands of bonds of varying maturities. To illustrate the degree of fragmentation and illiquidity due to the current issuance structure, the data below shows the number of benchmark-eligible, and therefore liquid, bonds there are across a number of European issuers (see the table on the right).

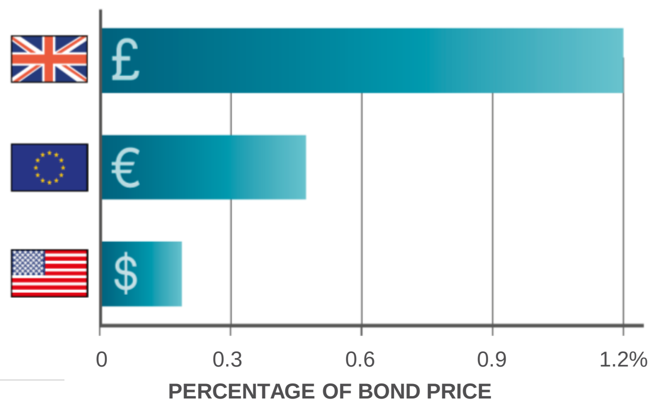
Issuer	Bonds in Barclays Euro Index	Share of Amount Out-standing	Total Euro Bonds Out-standing	Common Equity Securities
Rabobank	20	49%	218	1
BNP Paribas	22	24%	1011	1
Volkswagen	22	50%	86	1
Intesa Sanpaolo	16	13%	755	1
Crédit Agricole	15	15%	1047	1
HSBC	15	49%	275	1
ING	15	29%	558	1
Banque Fédérative du Crédit Mutuel	16	28%	230	1
Telefonica	13	65%	30	1

Source: Barclays and Bloomberg, April 2014

Delivering MiFID II and ensuring that the provisions relating to post-trade infrastructure connectivity are fully implemented – and where necessary enforced – will go some way to address this situation. But further work will be necessary from both industry and policymakers to ensure that European bond markets can play the role they need to in helping to provide finance.

COST OF DOING BUSINESS

Average high grade bid-offer spreads, 2013-2014



European companies face a higher cost of raising finance than their US counterparts due to market fragmentation and lower levels of secondary market liquidity

Source: MarketAxess and BlackRock Investment Institute, May 2014.
Note: The bid-offer spreads for US, euro and sterling high-grade corporate bonds are one-year averages and represented as a percentage of price

The current low interest rate, low volatility environment – which has spurred considerable demand for bonds – has masked underlying issues in the corporate bond market in recent years.[5] **We have seen decreased secondary market liquidity and a shift from a principal market to an agency market. This means that execution risk has shifted from bank to the end-investor.** A less-friendly market environment will expose the underlying structural weaknesses, and could see the potential for even lower liquidity and sharp, discontinuous price deterioration. Lack of liquidity in secondary markets for corporate bonds harms issuers and investor confidence alike.

There is no 'silver bullet' that will cure the liquidity challenge in Europe's secondary credit markets, but it is a challenge that needs to be addressed in the context of the Capital Markets Union. Beyond appropriately calibrated pre-trade transparency rules, as part of MiFID II, there are four drivers which, in concert, could substantially improve liquidity:[6]

- Standardisation of certain features of large new corporate bond issues (over €500m) will reduce the number of bonds and increase their liquidity
- In line with the spirit of MiFID II, migrating trading away from OTC to an increasingly centralised trading environment to uncover latent liquidity
- Adoption of new e-trading protocols, reducing reliance on scarce dealer capital
- Behavioural changes by market participants that recognise the need to address the bigger picture issues such as diversifying and reducing the cost of funding that is available to European companies

Bond market standardisation in the context of a Capital Markets Union

A movement towards selective standardisation of new issuance, accompanied by expanded e-trading venues and new trading protocols could go some way to addressing the liquidity challenge. These reforms would hasten the evolution from today's outdated market structure to a modernised, fit for purpose corporate bond market.

Adjacent markets such as government bonds, and agency and supranational bonds have all experienced standardisation in recent years, a process that has reduced complexity and improved liquidity in the products. The discussion around a similar process in corporate bond markets is at an early stage given the currently favourable conditions for new issuance. However, we believe it would be prudent to address the lack of liquidity in corporate bond today instead of waiting until market conditions require such action.

The key features of corporate bond market standardisation are designed specifically to apply to the larger, more liquid issues over €500m. Standardisation would allow them to be traded on exchange and would ultimately reduce the costs of issuance. The reduced inventory capacity of banks could then be used to support the smaller, more sporadic and idiosyncratic issues of smaller companies. In our experience, many of the larger, more frequent issuers already meet most of the features we suggest below:

- **Coupon and maturity dates for new issues over €500m specifically aligned to quarterly International Money Market (IMM) dates.**[7] This would allow the use of cleared interest rate swaps, as opposed to more costly bespoke derivative products to hedge interest rate risk.
- **New issues of five years and greater in maturity to have par call period of three months, to facilitate refinancing window**. This would provide flexibility for issuers and addresses potential concerns about from issuers with less predictable financing needs about concentration of refinancing risk.
- **Issuers to tailor maturity distribution of new issues to develop a liquid curve of benchmark bonds corresponding to major maturity categories.** To stimulate secondary market liquidity, a steady-state debt profile with a significantly reduced number of distinct securities is the longer-term goal. This should be balanced against the corporates' needs for an appropriately diversified maturity profiles and capital structures.

- **New issues to include exchange listing to facilitate market-making in multiple venues beyond traditional OTC forum.** This would facilitate additional liquidity and transparency and help to deliver the policy goals of MiFID II.
- **During transition phase, exchanges of 'old style' securities into new, liquid benchmarks.** This would be one way in which to facilitate the transition to a liquid market structure. The less diversified maturity profile for issuers is mitigated by a pre-maturity par call window.

We believe there are a number of benefits for systemic stability, issuers and investors arising from this process:

- Lower costs for new issuance, lower volatility, and more reliable market access for issuers will be a boon for financial systemic stability
- Increased secondary market liquidity and lower transaction costs will result in improved funding opportunities for European companies and greater investor confidence and participation
- Greater pricing transparency could unlock the possibility of increased retail participation in these markets

The discussion around the relative merits of targeted standardisation has begun – issuers, underwriters, investors and public policy officials have all expressed views on this subject in recent months. We would encourage the European Commission to study the issue further and as part of the impact assessment of the Capital Markets Union deliver economic analysis to quantify the potential opportunities against the overall objectives of the Project.

Equity market reform – the importance of a consolidated tape

In recent years, there has been considerable regulation at the European level to facilitate the integration and development of European equity markets.[8] However, the fairness and effectiveness of European equity markets continue to be undermined by the absence of a single authoritative consolidated tape, disadvantaging both investors and companies using capital markets as funding channels. Because investors in European markets currently find it difficult to answer two simple questions in relation to European equity – what is the price of a stock? And how many shares have been traded? – the cost of equity capital is driven up for companies. **From a Capital Markets Union perspective, delivering consolidated post-trade information across all asset classes is a pre-requisite to achieving an integrated capital market that works not only for investors but also for European companies seeking to raise funding through markets channels.**

Effective post-trade transparency is dependent on the delivery of harmonised and high-quality data. In our view, a precondition to the delivery of that data is the application of common and harmonised reporting requirements as a priority across the market. Once these standards are in place, authoritative post-trade data at reasonable commercial costs should emerge via competing consolidated tapes, reflecting the diverse needs of investors. However, if a credible commercial solution is not forthcoming for the provision of comprehensive consolidated trade data, we would encourage the European Securities & Markets Authority (ESMA) to advise the Commission to mandate a single authoritative consolidated tape provider.

IPOs

Within the current discussion around MiFID II there is a focus on how equity markets could better serve small and medium sized enterprises (SMEs) and a related discussion of how the initial public offering (IPO) process[9] could be further improved to incentivise more listings.

However, in our view, European market infrastructure is broadly fit for purpose for stock market launches. We believe that there is not so much a problem of supply of IPOs, but companies coming to market would attract larger amounts of more patient capital were they structured in a way to appeal to long-term investors. To improve the IPO environment more generally in Europe, we believe that effort would be best focused in looking at ways to improve preparedness of companies to go public, as opposed to encouraging more to do so. Other projects which have been discussed involve creating forums where companies can 'showcase' themselves to a range of potential investors leading up to an IPO.

What investors look for in an IPO:

1. Good governance standards and balance sheet structures
2. Experienced, fully committed management, free from conflicts of interest
3. Prudent accounting with sensible revenue recognition, with operating profits consistently turned into cash
4. Attractive valuation relative to peer group of companies
5. Incentive fees that align with longer-term share prices

A further review of the EU Prospectus Directive could simplify the process of producing the document, and streamline the information contained in it to remove duplicative or unnecessary disclosures which detract from assessing the key investment risks. In the same way that there has been a focus on more targeted narrative reporting in annual reports and accounts, we believe that prospectuses could benefit from a similar overhaul.

Equity ownership and a good governance loop

One of the hallmarks of equity ownership is participation in the governance of companies. This is both a right and responsibility that shareholders take seriously, and one that should be central to the Capital Markets Union**. A sound corporate governance framework, enabled by appropriate regulation, promotes strong leadership by boards of directors and good management practices, contributing to the long-term success of companies and thereby, enhanced savings and pensions for European citizens.**

The Shareholder Rights Directive proposal can put in place the tools to build such a framework. We have identified three main drivers which can support pan-European shareholders such as pension funds, insurance companies and collective investment funds:

1. A regulatory framework encouraging shareholders and companies to move from a dialogue primarily around discrete events, such as results announcements and the shareholder meeting to an ongoing relationship where all matters contributing to long-term business success are discussed
2. More fluid cross-border votes resulting in less discrimination between domestic and non-domestic shareholders
3. A consistent pan-European regime of related party transactions with improved governance and shareholder oversight.

The Shareholder Rights Directive proposal can address a number of these issues. The regulatory framework should focus on transparency as a means of raising the corporate governance bar and encouraging shareholders and companies to focus their engagement on issues that are decisive in shaping long-term business success – specifically, business strategy, capital allocation, execution effectiveness and board composition.

A more fluid cross-border voting chain is important for two main reasons. Shareholders based outside the country where the company is listed face operational and administrative issues in getting documents and having their vote sent to the issuer on time for the general meeting.

Improving the cross-border voting chain will help reduce the additional operational challenges facing cross-border shareholders[10], which, according to the EC, represent 44% of shareholders in EU companies. On the other hand, introducing differentiated voting rights, such as France's Loi Florange and the Italian law passed over the summer 2014, may hinder cross-border investments. These mechanisms de facto increase the voting power of majority, often affiliated, shareholders and decrease that of minority shareholders, who tend to be institutional investors. As a result of favouring one type of shareholder and breaching the equality of treatment among them, other things being equal, institutional investors will have less incentive to invest in cross-border companies and to engage in stewardship activities where they are invested.

Finally, each Member State currently has its own governance regime of related party transactions, leading to unequal shareholder protection across Europe. We welcome the fact that the Shareholder Rights Directive considers related party transactions, but would recommend a different approach. Rather than basing the need for a shareholder vote on transactions that are above 5% of the company's assets or transactions which can have a significant impact on profits or turnover, we recommend that shareholders only vote on material, transformational, transactions (those with an important impact on the company over the long term such as acquisitions, disposals and significant restructurings) and that the related party is excluded from voting. In addition, we believe that an independent review should be undertaken by the board or its audit committee of other transactions which, whilst not transformational, are important given the size and operational model of the company, and that these should be reported annually to shareholders.

STEP THREE:
Strong banks to support market finance and credit growth

The post-crisis banking sector reforms have strengthened the resilience of the sector considerably, and in our view, were necessary to reinforce the stability and integrity of the entire financial system. One of the side effects of some elements of this reform has been banks retreating from, or scaling down, certain market making activities. As we have outlined above, we feel that the resulting impact on the liquidity in the corporate bond market needs to be addressed via changes to the structure of that market.

There will always be a role for market making – either to complement the liquidity brought about via structural reforms on both equity and bond markets, or to help smaller, less liquid markets with infrequent buyers and sellers. While we do not advocate for a roll-back of existing prudential regulation to bring back the level of market making seen pre-crisis, we do feel there is merit in considering carefully how to balance the need for market making with future reform priorities. **Current discussions over the structure of the European banking sector should recognise that market making is likely to remain an important way of facilitating liquidity in infrequently traded, less liquid securities into the foreseeable future.**

Furthermore, because of banks' historical position as a primary lender in most national markets, they have the client relationships, information database and domestic networks which means that they are unlikely to be displaced as the primary creditor of most European companies (in particular, SMEs) in the short or medium term. The Capital Markets Union project should therefore look at ways that capital markets can help supply additional capital that banks can then use to increase lending.

Securitisation reform

Securitisation, when functioning properly, has the potential to increase the availability of capital for bank lending. For this reason, securitisation featured prominently in the Commission's Long-Term Investment initiative, and is an often-cited pillar of the Capital Markets Union. In our view, the low level of securitisation in Europe is due to a number of obstacles which exist for both issuers and investors:

On the issuer side:

- European banks' easy access to cheaper sources of funding via the European Central Bank and vehicles such as covered bonds has deterred banks from issuing publicly placed securitisations in any material way as these are seen as a comparatively expensive source of funding
- The weak macroeconomic context and Basel III obligations of banks to shrink their balance sheets have resulted in low volumes of credit originated
- Pre-crisis originations (banks' 'back books') may not have sufficient margins to support post-crisis funding costs (e.g. the returns required on securitised bonds).

On the investor side:

- Regulatory capital requirements have been and continue to be a significant disincentive for asset owners to invest in securitisations (for example, Solvency II for insurers)
- A disconnect exists between perceived risk and corresponding required return on the investor side and spreads at which issuers are prepared to securitise (due to loan margins / alternative funding sources as highlighted above).

In principle, securitisation allows a bank to remove assets from their balance sheet, clearing room to grow their loan books. Meanwhile, long-term investors are attracted to assets that match their longer-term liabilities. This virtuous circle is predicated on ensuring that securitisations are subject to a regulatory regime that considers and protects the needs of investors as well of those of the originator and sponsors. End-investor confidence is derived primarily from the ability of the asset manager to perform robust due diligence of the securitisation vehicle.

We therefore recommend the following guiding principles which could serve as a useful tool for policymakers to promote a sound, consistent and streamlined securitisation regulatory framework. We believe that regulation aimed at enshrining these principles will have a far greater effect in reviving a viable market and be more adaptable to future developments than one focusing solely on the credit quality of underlying assets:[11]

1. Set out high-quality, prudent underwriting standards that are evaluated and administered properly.
2. Establish quality servicing standards.
3. Ensure transparent and accessible asset and transaction information (at the time of securitisation and on an ongoing basis).
4. Ensure conflicts of interest are identified and managed properly.
5. Ensure structures are clear, complete and presented in an understandable manner.
6. Appropriately align originator, sponsor or original lender and investor interests (with originator, sponsor or original lender risk retention, where applicable).

Reviving securitisations will require the investor-centric regulatory framework described above and a consideration of the fundamental issues listed above, specifically the recalibration of Solvency II capital provisions, liquidity coverage ratio (LCR), and an upwards adjustment of bank lending margins.

SME securitisation

While we do not believe investor confidence is a significant issue in the wider securitisation markets, it is a factor specifically for SME securitisations. The perception exists that originators / sponsors may be motivated to sell their highest risk SME exposures which investors will find difficult to assess given the current information asymmetry between the parties (though this could be addressed in some part by the increased transparency brought by the most recent Asset Quality Review).

In addition, investor confidence in or transparency of originators' origination and servicing practices is important as the performance of SME loans is highly linked to the relationship between the bank and company (a factor that is not easily assessed from quantitative historic data). These factors can be addressed through: enhanced transparency allowing investors to perform comprehensive analysis of the underlying asset pools; and identification of potential conflicts of interest mitigated by fully disclosed, carefully documented terms. Ultimately, significant investor demand for SME securitisations will depend on greater standardisation and homogeneity in SME lending criteria and policies.

Bank loan financing

Growing the market in Europe for investors to be able to buy 'whole loans' could increase the availability of lending capital in Europe. These are bank loans syndicated or intermediated by a bank representing a line of credit to a single company, for instance, or an individual commercial mortgage. Bank loans have grown considerably in the US – as the pre-crisis issues have largely been addressed, and the investor base has diversified considerably to include pension funds, insurers and mutual funds.

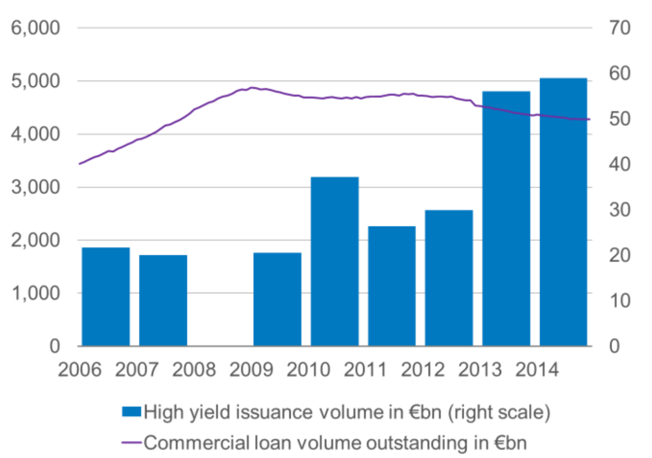
This could be mirrored in Europe via efforts to make the bank loans themselves more liquid so that more mainstream investors can buy and hold them. This would diversify opportunities for higher yielding investments. Europe has for example seen a greater growth in high yield bonds than in the US where this diversification already exists.

For an end-investor, bank loans as an asset class have some interesting properties relative to a majority of fixed income assets.[12] However, loans have traditionally been set up manually and are operationally complex to trade in volume. In the EU, one of the major impediments to loans being held within UCITS (and hence growth of the market) has been the mismatch between settlement periods for bank loans which are longer than the settlement periods for comparable fixed. income securities, which typically settle in two days under TARGET2-Securities. This delayed settlement period may cause a potential liquidity mismatch for mutual funds offering daily liquidity.

We would encourage regulatory initiatives to operationally transform bank loan assets into 'security-like' instruments, through a reduction in the settlement window making settlement of these loans closer to bonds and other securities. As well as driving greater structural liquidity, it could also enhance market liquidity were policy makers to then accept bank loan assets as eligible assets for UCITS (either directly or indirectly through a pooled vehicle such as the ELTIF).

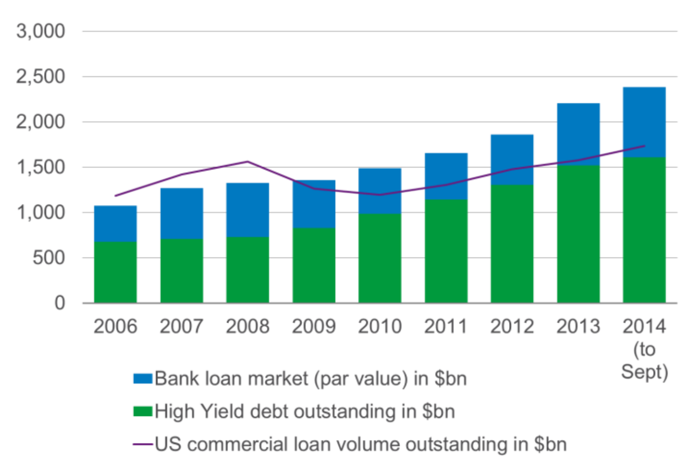
A TALE OF TWO MARKETS

Commercial lending v High Yield debt issuance (Eurozone)



Source: ECB and Standard & Poor's Capital IQ LCD

US Commercial lending v High Yield and Bank Loan markets



Source: US Federal Reserve Bank of St Louis Economic Data, Bank of America Merrill Lynch and Standard & Poor's Capital IQ LCD

STEP FOUR:
Developing Private Markets in Europe

A deeper private credit market could offer additional sources of funding for European corporates. This is a nascent, rapidly growing market which will perform a valuable economic role in the medium term. However, to grow significantly the market in areas such as infrastructure and other illiquid classes, potentially more difficult pan-European political reforms are required. In this section we examine how to encourage the growth of private capital provision, particularly to SME and infrastructure projects.

There are a number of common characteristics across these asset classes that, were they in place, would enable a far stronger supply of private credit available for lending, which could in turn, supplement bank lending and public markets as an additional source of funding for European companies.

- **Transparency**: access to comprehensive data sets on investment opportunities and to an asset class' performance history.
- **Level-playing field**: the removal of national barriers which discriminate against capital markets investors in favour of bank based investors, such as withholding tax on loans or private placements.
- **Standardisation** of documents and operational processes. This will allow their inclusion in standard industry benchmarks and so help to gain significant traction among institutional investors.
- **Predictable procedures and outcomes** under national insolvency laws: asset managers look at both the investment proposition and the national insolvency regimes when deciding whether to invest. Companies active in countries with creditor-friendly and/or predictable insolvency laws are likely to enjoy a lower cost of capital and greater flows of market–based finance than companies in countries with less friendly ones.

Pooled investment can help channel investor capital into these opportunities more effectively. However, across Member States, we have noted that there are numerous restrictions on institutional investors investing in pooled fund solutions holding illiquid assets, such as prohibitions on allocating investments into Alternative Investment Funds (AIFs), and tax disincentives on investment into AIFs. As well as direct legislative action looking at new investment vehicles, **we also believe the European Commission can provide a valuable role in encouraging Member States to update their national frameworks to reflect and provide a supportive and consistent regulatory, tax and accounting framework, to encourage increased financing by investors to long-term investment opportunities.**

BEPS

The Organisation for Economic Cooperation and Development's BEPS initiative seeks to address double non-taxation by multinational corporations. We support the overall project, however, if implemented as proposed, BEPS will have significant consequences for investment funds, in particular, those investing in real assets such as infrastructure, real estate, and renewable energy. Cross-border flows and investment in these assets classes will fall as a result.

We believe that it is possible to find solutions that meet the objectives of policy makers and retain the utility of cross-border investment funds. The key lies in leveraging the data provided by the various international and European tax transparency initiatives such as BEPS, CRS and TRACE to facilitate solutions that meet the objectives of policy makers whilst retaining the cross-border use of funds.

SME direct lending

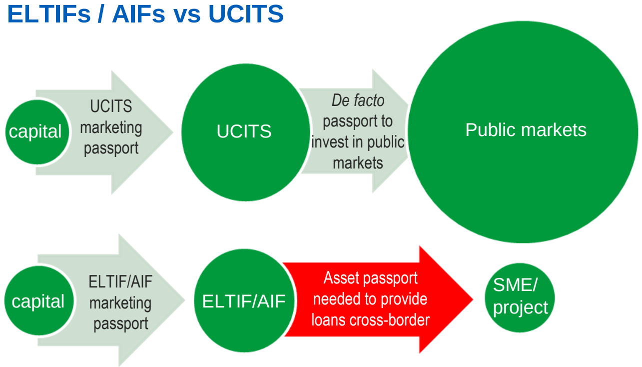
The ability of investors to provide financing directly for SME loans (for example via loan origination funds) could be further enhanced by addressing the issue of lack of information. Data is only one component of investment selection, but public data held on SMEs outside the banking system across the EU is patchy and incomplete. To encourage greater investment in SMEs, investors need more detailed information to make proper due diligence possible with particular focus on default history, management and personnel track record. Systems such as the Banque de France repository of information (FIBEN), or Electronic Data Gathering, Analysis and Retrieval system (EDGAR) in the US, provide the level of information which institutional investors need to drive long-term investment in the sector.

The first step to addressing this information gap would be to agree a standard breakdown of different types of SME by size and turnover allowing policy makers and investors to focus on those SMEs which are likely to drive future growth. Consequently, this could enable standards for collecting and reporting on SME data**. As this will be a significant exercise, we would recommend starting with the largest medium or intermediate-sized companies where the impact will be most visible.** Enabling access to comprehensive and up to date data by approved market finance providers in all EU Member States would have a considerable impact on investor willingness to invest in what are, to date, unfamiliar asset classes.

ELTIFs and the asset passport

Funds such as European Long-Term Investment Funds (ELTIFs) could potentially serve as a pan-European structure to augment the supply of capital available for lending in Europe. In parallel, a number of Member States have looked at creating a framework for loan origination funds as sources of additional capital under the AIFMD – for example the recently launched Irish loan origination fund, the LOQIAIF. One of the major barriers to developing these fund structures into an effective tool for cross-border capital funding is the lack of a level playing field for non-bank providers of credit when compared to bank lenders. The ELTIF constitutes a valuable first step in encouraging greater allocation of capital to non-listed asset classes, but additional measures are needed if it is to emulate the success of the UCITS.

INVESTMENT BARRIERS IN PRIVATE MARKETS: ELTIFs / AIFs vs UCITS



While it is intended that the ELTIF, like UCITS, will have a pan-European marketing passport to raise cross-border capital, the ELTIF does not have the same ability as a UCITS to deploy that capital cross-border. Many barriers still exist at national level which prevent an ELTIF or loan origination fund from realising pan-European investment opportunities. Many of these barriers are bound up with national banking predominance, insolvency laws and tax regimes which will take many years to harmonise. This should not, however, cause the ELTIF to be put on ice as **we recommend the creation of asset passport which could be used by ELTIF to provide capital on a level playing field with banks.** If set up as a pan European '29th regime' this would grant the ELTIF (and possibly other national AIFs similar to an ELTIF) the same rights in national regimes as bank-based lenders, so encouraging a more diversified funding base for European companies and infrastructure projects.

Key areas of focus which an asset passport should address include:

- The lack of explicit recognition of a loan origination fund in one Member State to originate loans in another Member State or to act as the lender of record
- Barriers to lending (as distinct from deposit taking) such as the need for banking licenses which prevent regulated institutional investors and funds from making loans
- The legislative preference given to banks, for example in bankruptcy proceedings
- The lack of standardised procedures for taking security, enforcement and for creating loans / bonds, in particular equivalent standards for European company registers for registering and enforcing pledges and similar charges
- Restrictions on access to the type of comprehensive data needed to make an informed risk-based decision on investment opportunities
- Different tax treatments on withholding tax on interest depending on the type of investor

Infrastructure investing

Many of the structural issues in providing credit to companies also apply to investment in infrastructure. Infrastructure investing in both equity and debt is of increasing interest to investors. But for investors to commit more to long-term infrastructure, the opportunities must meet their investment requirements. In many cases, institutional investors still require both a greater historical data and the clear pipeline to develop teams with the specialist skills needed to make investments. In this respect we very much support the recommendations made by the Economic and Financial Committee's High Level Expert Group (HLEG)[13] on encouraging the publication of project data on infrastructure. We believe that the Commission's recent proposal to create a European Fund for Strategic Investments (EFSI)[14] can make great strides against this recommendation by delivering a central database for this data for viable projects across Europe.

Complexity is another issue. Infrastructure financing often contains a very high legal content that leads to complexity that not all institutional investors are able to cope with. Larger institutional investors with dedicated infrastructure finance teams will not have an issue with such complexity, but smaller institutional investors will and may not have the capacity to invest to the scale required by many infrastructure projects. For governments to tap into the pool of funds that smaller investors might be able to supply, standardisation of project documentation would be beneficial.

A holistic view of the investment opportunity is needed as all parts of the investment proposition have to work together and for such long-dated investment structures certainty is key. Without structural certainty the nominal investment return remains a headline figure. Investors need confidence that the project is economically viable (e.g. toll prices that make sense to consumers), contractual certainty (such as legal enforceability) and regulatory certainty (confidence that a government or municipality will not change the terms of an opportunity).

To address these concerns, we recommend:

- A clear focus on establishing high-quality data and analytics from the outset. In our experience, institutional investors expect asset level data, credit analysis and time series data. Greater take up of infrastructure will develop when this data becomes more widely available. Initiatives by the European Commission to encourage specialised rating agencies, or co-operation between European and national multilateral development banks in data sharing could be invaluable in this process.
- Publication of a clear and consistent pipeline of projects such as a regularly updated national and regional infrastructure plans would encourage investors to build up the specialist teams needed to invest. We hope that the EFSI could be part of this process.
- Designing a consistent regulatory framework for key sectors such as infrastructure which provides for predictable pricing or tariff structures, otherwise contractual and regulatory uncertainty is likely to result in investors requiring higher risk premia or deciding not to invest at all.
- Financing could also be increased were authorities able to encourage fund managers and institutional investors to support consortia at the bidding stage of a project – this could come about via changes to the procurement process.

Conclusion

The Capital Markets Union has the potential to, over time, fundamentally reshape the European economic landscape and enable a considerably wider range of funding sources than exists today. However, the key to ensuring this is not only looking at existing barriers to how capital moves, creating new vehicles to move it, or providing tools to address information gaps, but also ensuring that the result is more attractive investment opportunities.

This means putting the investor at the heart of the Capital Markets Union reforms – as investors are the 'Capital' in a 'Capital Markets Union'. Policymakers should look closely at how and why investors allocate their capital, developing an understanding of their specific investment needs, and ensuring that these form a key pillar of how we create a roadmap for reshaping Europe's capital markets in the coming years.

Perhaps most fundamental is the need for a coherent regulatory framework – certainty in this regard is one of the fundamental factors for investors in deciding how to commit capital, and the longer-term the holding period for the asset, the more important certainty becomes. In our view, the greater the policy focus on creating a comprehensive framework that puts investor needs at the centre, the greater investors' ability will be to invest in Europe, and hence, the greater the benefit to the European companies.

ROADMAP TO A CAPITAL MARKETS UNION

	GOAL	NEXT STEPS
INCREASING SAVINGS		
MIFID	▸ Distribution regime must deliver meaningful improvements for investors across Europe by enhancing the quality of service they receive through increased focus on suitability and product governance. ▸ Level 2 rules need cover the full scope of exchange-traded products to ensure a level playing field, and ensure that the trading of exchange-traded products takes place on regulated markets to the greatest extent possible.	Implementation
PRIIPS AND IMD	▸ Deliver meaningful comparability and transparency across different types of investment products (in conjunction with UCITS and MiFID).	Implementation
DIGITAL INVESTMENT PASSPORT	▸ Using advances in technology, a 'digital investment passport' would hold savers' administrative information to make the process of investment advice and guidance more efficient.	New initiative
CROSS-BORDER PENSIONS	▸ A cross-border pensions product could help channel more savings into the market – but further consideration is necessary on the potential demand for, and operation feasibility of, such a product.	Impact Assessment needed
BENCHMARKS	▸ Achieve meaningful differentiation between critical and non-critical benchmarks, and address conduct issues in critical benchmarks.	Political agreement
CCP RECOVERY AND RESOLUTION	▸ Legislation needed to ensure that investor capital protected to the greatest possible extent in the event of a CCP default.	New proposal needed
BANKING REFORMS		
BANK STRUCTURE REFORMS	▸ Ensure banks' ability to continue their market making function in less liquid asset classes.	Political Agreement
REVIVAL OF SECURITISATION	▸ Investor-centric regulation that establishes a consistent framework for securitisation. ▸ Revisiting risk-weighting calibrations (e.g. Solvency II) and other requirements for investors.	New proposal needed
BANK WHOLE LOANS	▸ Making bank loans into a more security-like instrument to enable more liquidity – thereby opening up new investor bases.	New initiative
PUBLIC MARKETS		
MIFID	▸ Appropriately calibrated pre-trade transparency rules for fixed income necessary to preserve liquidity in bond markets. ▸ Delivery of a consolidated tape for equity markets and meaningful post-trade transparency for fixed income.	Implementation
CORPORATE BOND MARKET REFORMS	▸ Look into feasibility and benefits of standardisation of some elements of new bond issuances.	Impact Assessment needed
PROSPECTUS DIRECTIVE	▸ Simplify process for issuing prospectuses and see where disclosure requirements can be streamlined.	Commission Review
SHAREHOLDERS RIGHTS	▸ Deliver a framework for corporate governance that enables cross-border voting, addresses different treatment of domestic and non-domestic shareholders, and provide a consistent regime for related-party transactions.	Political agreement
PRIVATE CREDIT MARKETS		
BEPS	▸ Protect tax treatment of private funds (e.g. ELTIFs/ AIFs) – where most investment into private markets.	Political Agreement
PAN-EUROPEAN SME INFORMATION REPOSITORY	▸ Building on national databases, a single point for investors to access relevant credit information for potential SME investments should be built.	New initiative/ expansion of national infrastructure
CONSISTENT INSOLVENCY REGIMES	▸ While a single EU Insolvency regime is a long-term project, more predictable procedures under existing national rules would be a valuable first step – the Commission could encourage this in the shorter term.	New initiative
CENTRAL DATABASE FOR INFRASTRUCTURE PROJECTS	▸ The European Fund for Strategic Investments plans a single EU project pipeline – this should be secured.	Implementation
ELTIF	▸ Member States should give ELTIFS 'most favoured' tax status to encourage new capital commitments. ▸ ELTIFS must be able to invest capital on an equal footing with banks. A new 'asset passport' could address this.	Implementation New proposal needed

Endnotes

1. Available here: http://www.blackrock.com/investing/insights/investor-pulse
2. See Feedback statement from the Committee of European Securities Regulators on "Understanding the definition of advice under MiFID", http://www.esma.europa.eu/system/files/10_294.pdf
3. Post-implementation review of the Retail Distribution Review - Phase 1: http://www.fca.org.uk/your-fca/documents/post-implementation-review-of-the-retail-distribution-review-phase-1
4. "Capital Markets and Economic Growth – Long-Term Trends and Policy Changes" by Christoph Kaserer, Professor of Finance, Chair of Financial Management and Capital Markets, TUM School of Management, Munich, and Marc Steffen Rapp, Professor of Finance, Accounting & Finance Group, School of Business and Economics, Philipps-Universität Marburg, Germany. Available online at: http://www.aima.org/en/education/research-into-capital-markets-and-economic-growth.cfm
5. For further details see our *ViewPoint*: "Corporate Bond Market Structure: the Time for Reform is Now".
6. Of the above drivers, electronic trading venues have seen the most activity to date but without a concurrent change in the underlying market structure, activity will simply transfer to voice trading, rather than truly broaden liquidity and in doing so undermine the laudable aims of the MiFID II reforms.
7. The trade on maturity dates of money market futures and money market futures options which are set by futures and options exchanges. These dates are always the third Wednesday of the last month of the quarter (March, June, September and December).
8. The reform of equity markets in Europe spans the Investment Services Directive enacted in 1996 through to the set of reforms to be ushered in with MiFID II in 2017.
9. The process by which shares in a company are sold to institutional investors that in turn sell to the general public, on a securities exchange, for the first time.
10. The EC in the Impact Assessment accompanying the SRD proposal identified price discrimination by intermediaries for cross-border transmission of information, including exercise of shareholder rights as a barrier to the Single Market.
11. For further details see our *ViewPoint*: "Securitisation: A Tool for European Growth".
12. For further details of the characteristics of loans held with US mutual funds and recommendations of reducing liquidity concerns see our ViewPoint: Who Owns the Assets? A Closer Look at Bank Loans, High Yield Bonds and Emerging Markets Debt.
13. The full HLEG report is available at: http://europa.eu/efc/working_groups/hleg_report_2013.pdf
14. For further details on the EFSI see the Commission's dedicated website at: http://ec.europa.eu/priorities/jobs-growth-investment/plan/financing/index_en.htm#efsi

RELATED CONTENT

BlackRock's Global Investor Pulse Survey 2014
ViewPoint – Corporate Bond Market Structure: the Time for Reform is Now, September 2014
ViewPoint – Who Owns the Assets? A Closer Look at Bank Loans, High Yield Bonds and Emerging Markets Debt, September 2014
ViewPoint – Who Owns the Assets? Developing a Better Understanding of the Flow of Assets and the Implications for Financial Regulation, May 2014
ViewPoint – The Changing Face of European Distribution: A Better Financial Future for Savers?, May 2014
ViewPoint – Central Clearing Counterparties and Too Big to Fail, April 2014
ViewPoint – Securitisation: A Tool for European Growth, March 2014

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