CMU 3.0: toolbox to further shape the EU Capital Markets – from outstanding issues to fresh ideas

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CMU Reloaded: How to Increase the Attractiveness of EU Capital Markets – to the Benefit of All Market Participants

Several major trends are changing the global economic landscape. Continuing uncertainty arising from regulatory, fiscal, political, social, and environmental pressures dominates the short-term horizon for both European governments and companies. The European fund sector can play a key role in tackling some of the challenges resulting from the evolving global economic environment by alleviating the pressure on pension systems, providing funding for companies, and contributing to the transition to a more sustainable environment. However, this can only be done within a commensurate regulatory framework that preserves and strengthens the European asset management sector's competitiveness in the global economy. EU regulatory initiatives are tying up enormous resources that could be invested for example in innovative products and technology. Fostering the competitiveness of the European economy to allow it to compete on the global scene should therefore be an overarching goal in EU regulation, in addition to financial markets stability and investor protection. We encourage European legislators to consider the following recommendations to help achieve this goal.

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1. Adding the missing pillar to regulation

On a global level, the European asset management industry is operating in an extremely competitive environment. EU fund providers are contending with their peers from non-EU jurisdictions for investment opportunities as well as for investors. This challenge remains virtually unrecognised in current EU regulation which largely focuses on consumer protection and systemic risk. This has resulted in massive over-regulation for the European asset management industry which has to dedicate enormous resources to compliance with this regulation.

Other jurisdictions, such as the United States, also take investor protection and systemic resilience into account. However, they have complemented these legitimate political objectives with a third one: fostering the global competitiveness of the domestic financial industry. In doing so, they give the relevant industries more financial leeway to invest more money in forward looking aspects of business such as artificial intelligence, big data and other technological developments, which in turn strengthens their competitiveness at the global level.

In fact, also President von der Leyen has recently acknowledged global competitiveness to be an important objective of rulemaking.[1] Since then, however, not much has been achieved.

Recommendations

- The "scope of action" of the European Supervisory Authorities (ESAs)[2] shall be amended by adding as the need to strengthen the global competitiveness of the relevant industry as an additional objective. Assets under management, employment numbers and revenue could serve as criteria to determine the competitiveness of the European sector.

- To enhance awareness at an institutional level we suggest the creation of a specific unit in DG FISMA and/or the Secretariat General of the Commission dedicated to ensuring the competitiveness of European financial services sector is actively fostered. In addition, the criteria for the impact assessment of proposals by the Regulatory Scrutiny Board should be amended to ensure that this element of competitiveness is fully taken into account.

- The EU voice in international standard-setting organisations, such as FSB and IOSCO, should be strengthened; key European interests should be pursued more vigorously.

- Allow the ESAs to issue time-limited 'no action letters' to avoid situations of practical impossibility for financial actors to apply new regulation.

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[1] At the European Parliament Plenary on the preparation of the European Council meeting of 20-21 October 2022, EU Commission President von der Leyen said: „I am concerned about the competitiveness of our economy – not only concerning the Single Market, but also concerning the global competitiveness of our economy. […] we will introduce a standard competitiveness-check in our regulation. I think it is time to do that."
[2] Laid down in the founding Regulations (EU) 1093, 1094 and 1095/2010,

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2. Delivering on “better regulation”

For many years the EU has been heralding its commitment to “better regulation”. The result, however, is no less than disappointing. EU legislation with relevance to the fund sector is unabatedly growing on all levels. The result is a huge pile of red tape, leading to excessive compliance costs on behalf of the affected industry while the political goals were mostly missed or even thwarted. Once again, MiFID II and PRIIPs come to mind as negative examples. The Commission and legislators increasingly use the Lamfalussy procedure to avoid taking controversial decisions by delegating them to Levels 2 and 3, as we currently see in the Commission’s proposal for a retail investment strategy. This is all the more unfortunate since the entities in charge of these procedures have to deliver within a – usually ambitious – timeframe set on Level 1, which usually comes at the expense of quality and leads to delays: both MiFID II and PRIIPs legislative procedures had to be extended because of this problem. Finally, diverging reporting standards pose increasing problems for market participants.

Recommendations

- EU legislators should take into account the distinct business model of asset managers and their respective products and services in comparison to other market participants such as banks or insurances when considering further regulation. The asset management sector is already subject to a detailed and robust specific regulatory framework at the EU level.

- Capital market infrastructure regulation should be planned in a holistic manner from the needs of front to middle and back offices throughout the whole value chain of asset management.

- 15 years after the financial crisis, there should be a pause in regulatory initiatives to allow existing regulation to be closely scrutinised in respect of its overall effectiveness and consistency.

- Streamline existing reporting obligations to remove inconsistent, duplicative, or overly complex requirements and to build on the conclusions of the public consultation on the fitness check of supervisory reporting requirements (e.g. UCITS, AIFMD, EMIR, SFTR, MiFID/MiFIR reporting).

- Require the use of global open ISO data and messaging standards wherever possible.

- Financial regulation should become again more principle-based to allow for more proportionality and adaptation to different business models.

- EU legislators must make elementary decisions themselves during the Level 1 procedure, rather than dumping them on Level 2 and Level 3 discussions.

- The entry into force of legislation, especially of Level 2 measures, shall provide for sufficient implementation time taking into account digital processes, e.g., starting dates should be after a weekend to allow for testing.

- Consultations, impact assessments and evaluations in the REFIT program should not only take scientific cost/benefit analyses of future legislation into account, but also include practical experience from market participants. This could also foster fair access to, and price for, data provided by market data providers (data and benchmarks providers, platforms). Impact assessment s should be open to consultation and legal challenge by market participants. In contrast to the US, EU impact assessments if they exit often lack a sound data basis and are often based largely on qualitative judgement.

- Reviews of existing legislation should be used to do away with unnecessary red tape that burdens market participants without any tangible benefit. The recent ELTIF review is a rare positive example for a constructive and enabling review procedure.

- The register of information according to DORA (Regulation (EU) 2022/2554, in particular on Level 2) is too complex and leaves the formats of relevant reporting data to the discretion of NCAs. It would therefore be desirable to standardise such interfaces at EU level.

- The Base Erosion and Profit Shifting (BEPS) rules agreed at OECD level have been transposed into EU Directives almost without allowing room for European or national specificities. As a result, the wording of the EU Directives is too restrictive, and Member States can only implement the rules with far-reaching changes to the local tax system. In order to meet the requirements, the rules are then implemented separately, creating new additional reporting and declaration obligations. The tax reporting burden has increased dramatically in recent years. This should be remedied.

3. Aligning the measures of the EU Sustainable Finance package

The transition to a more sustainable environment is one of the key challenges for Europe. The EU Sustainable Finance package has gained a level of detail and granularity that imposes a huge burden on the financial industry. This is even more the case since the various rules and provisions still lack consistency and often lead to duplicative or even conflicting obligations.

In general, the dynamic of the current transformation of the financial sector must not be impeded through overburdening, duplicative and inconsistent requirements. Market participants must be able to move forward from their different starting points to prevent discouragement of engaging in sustainable finance. To ensure that sustainable finance reaches its full potential and to allow the entire European financial industry to contribute to more sustainable development, we recommend the following:

Recommendations

- Sustainable finance regulation shall distinguish between the mandatory management of financial risks and the voluntary financing of sustainable goals. Legal requirements shall neither interfere with investors' free decision nor determine the use of their capital.

- Sustainable finance regulation shall promote a positive and forward-looking approach towards sustainability. Overly strict requirements will impede the perception of sustainability as an element of corporate strategy and lead to "tick the box" compliance exercises.

- Sustainable finance regulation shall not focus on the "green niche", but facilitate a viable transition of the real economy, considering the different business sectors and their respective challenges.

- Sustainable finance regulation shall be part of a comprehensive sustainability strategy, ideally based on common measurable objectives agreed at international level, voluntary mobilisation of capital as well as mandatory consideration of material risks to the return of investment.

- Sustainable finance regulation should facilitate investors' understanding and choice in terms of sustainable investment options. We support the establishment of a voluntary system of product categorisation as a core element of SFDR review. Such system should be based on the underlying sustainability concepts of financial products and be designed in a principle-based manner that works for different asset classes as well as for products investing in a variety of assets. The future product categories should be designed to reflect different investor preferences and not be put in a hierarchical order. They should be simple and intuitively comprehensible for retail investors. Introduction of sustainable product categories should be also directly linked to a review of sustainability preferences under MiFID and IDD.

- The quantitative Principal Adverse Impacts (PAI) reporting at entity level should be abolished (Art. 4(2)(b) SFDR, Art. 6 SFDR Delegated Regulation) and other reporting standards under SFDR and CSRD fully aligned.

4. Facilitating innovative solutions for retirement provision

Funds are the backbone of old-age provision and enable participation in economic growth. Hence, we welcome the inclusion of funds in the legislative work on the Pan-European Personal Pension Product (PEPP). However, the fee cap of 1% of the annual savings amount enshrined in Level 1 and finalised in Level 2, makes the PEPP economically unviable for potential providers. This problem should be tackled again in future legislation. The PEPP should foster an EU Single Market for personal pensions by addressing fragmentation between national markets, enabling cross-border distribution, and fostering competition.

Recommendations

- When undertaking the review of the PEPP Regulation, the Commission should initiate an evidence-based evaluation of the success of the launch of the PEPP market. A particular focus should be on the viability of the 1% fee cap regime whose weaknesses ought to be removed in the further regulatory process.

- The adoption of a Retirement Savings Action Plan to encourage EU citizens to save more for their retirement. Such an action plan shall include the launch of an ‘EU Retirement Savings Week’ and the development of guidelines and tools to help EU citizens understand the impact of the ageing population on the level of public pensions by 2030-2040.

5. Paving the way for data availability as the motor of EU financial markets

The EU financial industry relies on the availability of financial market data of all kinds. High-quality data is an essential precondition for the whole value chain of asset management to function properly.

Recent amendments to MiFIR that have strengthened market data transparency are a step in the right direction. The EU is clearly stating that the pricing of financial market data must be based on the cost of producing and disseminating such data. The provision of the European best bid offer in real-time consolidated tape for equities and ETFs offers investors an indication for their trades. However, EU legislators lacked the willingness to provide comprehensive transparency in pre-trade data.

Nevertheless, the persisting threatening jumble of different data standards and formats in regulatory reporting presents a huge burden for both the fund industry and the Competent Authorities in both operational and financial terms and impedes efficient supervision concerning the analyses of systemic risk within the financial markets. Enhancing consistency of regulatory reporting in terms of content is therefore strongly needed to enable the regulators across the board to use the stored data for the purpose of detecting systemic risk and to keep the administrative burden for the reporting entities at a reasonable level while taking into consideration the EU principle of proportionality.

Moreover, European authorities (ESAs/ESRB/ECB) should be required to disclose the outcome of the analysis of the reported results to the market participants with a view on the macro-systemic impact. These figures could be used by the asset manager to identify the effect of macro-systemic shocks affecting the economy. To tackle often overlapping data points being collected, extensive individual reporting, and the impression of whether the data is really used or evaluated by the Competent Authorities, a common data dictionary (e.g., a single domain (fundsstatistics.eu)) should be created, to help to improve market comprehension and acceptance.

Furthermore, financial data is often available only via natural monopolies or oligopolies like exchanges, rating agencies, or index providers which are in most cases US firms. Their market power allows them to unilaterally dictate the conditions for obtaining data which are essential for asset managers to perform their business. In recent years, we have seen massive price increases and costly bundling of individual licences. Data users have no alternative to agreeing into these increasingly expensive and complex licence models.

Lastly, the EU Commission concluded that a single-sided reporting of exchange-traded derivatives (ETDs) could greatly simplify the reporting burden without adversely impacting the transparency of the derivatives market. While central clearing counterparties (CCPs) will face a slightly higher burden, they are well equipped for this task and the overall reporting burden will decrease as the reporting requirement concerning ETDs will be eliminated for all other counterparties.

Recommendations

- Further improve the prudential framework for provision and use of financial market data at reasonable commercial terms in MiFID/MiFIR and CRAR along the lines of the pricing mechanism stated above. Extension of the MiFIR rules on pricing, pricelists, and costs of production rules together with new limits on excessive license terms and conditions to other regulated data usage, either a vertical approach within in particular in BMR, CRAR, and ESG regulations, or – preferably – a Data Vendor Act as horizontal regulation similar to DORA.

- The EU should set up a BMR benchmark data repository, including index levels, prices, weightings, and constituents. As much benchmark data as possible should be collected by the public sector and made available via public databases (Open Data) free of charge and licences.

- The European Ratings Platform (ERP) operated by ESMA needs to be made fit for institutional use by providing more easy and increased data usage options as well as legal certainty on the reuse of credit ratings data provided by the ERP.

- Clarifying in EU law that market data is not protected by copyright and removal of the EU data base regulation.

- Make the ESAP work as the public utility reference data base for all financial market participants.

- The Consolidated Tape, as introduced in MiFIR recently, must be extended by pre-trade data such as current bid and order prices for shares.

- Further streamline the reporting obligation for all relevant financial counterparties (UCITS/AIFs).

- To allow for full data exchange and create a type of data lake for CBs, ESAs, and other parties, to avoid individualized reporting, while also ensuring that the quality of data needed for monitoring derivatives markets and identifying financial stability risk is not lost.

- Streamlining EU level supervisory reporting requirements and creating a common data dictionary.

- European Commission to introduce single-sided reporting for all OTC derivative contracts.

6. Realising the potential of new technologies

The emergence of the four technologies namely distributed ledger technology (DLT), big data/artificial intelligence, cloud computing and crypto assets has the potential to lead to a fundamental change in the financial services industry. However, regulatory obstacles currently prevent the integration of some of the technologies. Specifically, investments in crypto assets by the investment fund industry will in particular depend on the extent the regulatory framework for UCITS funds allows such investments. The funds industry's interest is both on those crypto assets that represent securitized underlyings in financial instruments (bonds, shares) and real estate, which are currently allowed for most regulated funds, as well as non-traditional investment opportunities such as Bitcoin.

Furthermore, in general, the assets of an investment fund are held by a depositary – an entity independent from the fund's investment manager. In order for this safekeeping to take place in an operationally meaningful way in the future, depositaries have to be entitled to conduct the safekeeping regardless of whether they relate to traditional or crypto assets, which include payment tokens such as a digital Euro. In order to realise the potential of new technologies in the asset management industry, we recommend the following.

Recommendations

- The application of innovative technologies such as big data and artificial intelligence as well as cloud computing needs to be compatible with the supervisory regulatory framework.
- Forward-looking planning of what will happen after the pilot phase of the DLT pilot regime has ended to give market participants a perspective.
- In light of MiCAR and the issuance of crypto assets and stable coins, the suitability of such investments by UCITS and ELTIF investment funds should be clarified.
- The depository must remain in charge of safe-keeping assets, regardless of whether the assets are traditional or crypto-assets, i.e., uniform custody of all types of assets by depositories of investment funds.
- For UCITS depositories the custody of tokenized securities which are financial instruments should not require any additional licences in the Member State where the depository provides cross-border services.

7. Using EU capital markets for achieving political goals

Europe faces historically complex challenges. At the same time, many institutional and retail investors believe in the opportunities to be found in reinforcing and transforming Europe's economy. The asset management industry stands ready to match investors' money with relevant projects, a task it is uniquely equipped for. However, to be as effective and efficient as possible, enough investable projects as well as a strong and reliable framework for project investment are necessary.

Recommendations

- European Impact Bonds/Funds[3]: Bringing together asset managers' capital and long-term projects: These bonds would be linked to social or environmental EU projects and designed according to the evolving EU Green/Social Bond standard. In a first step, grants distributed in the EU's regional and cohesion policy should be securitised. This increases the total amount available for EU project financing in the short-term substantially, thus providing a meaningful private contribution to the crisis response. The new European Impact Bond market could quickly reach several hundred billion Euro – and be expanded further by including private sector projects.

- EU Index family: An EU Index Family could address two sets of important issues. First, the neglect of listed SMEs in the current index environment could be addressed by including them in a specific CMU index covering all EU-27-listed companies. Such a CMU index would then enable a set of sectoral or thematic sub-indices to be created (e.g., CMU Convergence Index, CMU SME Growth Markets Index, CMU ESG Index, and so on). This in turn could lead to larger local and foreign capital inflows from a broad range of investors, and better access to finance (in particular equity) for a larger pool of companies, with SMEs having most to gain. Second, addressing the overall neglect of several of these small markets would mitigate the different country classifications at EU Member State level, as investors would be able to perceive the markets as a single union. This can ultimately improve index weights for EU countries when compared to standard indices.

- Asset managers' investments are not affected by the current proposals to revise the securitisation framework, as these deal exclusively with the capital and liquidity requirements of banks and insurers. The securitisation regulation (EU) 2017/2402 sets high requirements that do not make (also STS) securitisations attractive for asset managers. Nevertheless, we currently see no need to adjust the European requirements regarding the conditions under which an asset manager may acquire securitisations for funds.

- We support the aim to achieve an efficient, integrated, and safe market for securities clearing and settlement in the EU, particularly for cross-border transactions. Although market participants are already facing significant technical, operational (e.g., Foreign Exchange (FX) and funding), and regulatory challenges due to the need to adapt their systems/procedures with the US move to a T+1 settlement cycle, moving to T+1 in Europe should be pursued for competitive reasons.

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[3] https://www.bvi.de/fileadmin/user_upload/2020_10_Policy_proposal_-_European_Impact_Funds_final.pdf

- Effective supervisory coordination is needed to facilitate financial integration in the Single Market. By promoting supervisory convergence and providing solutions to cross-border issues, the ESAs are at the heart of further endeavours to deepen the CMU. Generally, entrusting the ESAs with single supervisory functions can make sense in areas of the financial market that are fully harmonised and characterised by significant cross-border activities. This is so far not the case in the investment fund sector where the central pieces of regulation for UCITS and AIFM have recently been reviewed and confirmed as EU Directives that require transposition in national law and are closely interrelated with the national systems of corporate governance. A single supervisor would need to be acquainted and deal on a daily basis with up to 27 different national regimes which could be hardly seen as improvement in terms of effectiveness of supervision or lowering costs for investors.

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