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AMAFI Position Paper

CMU 2.0: enabling EU financial markets to play a bigger role in the financing of the European economy

As post-crisis regulations put more constraints on bank financing, financial markets have a bigger role to play in financing the economy. In that context, the European Commission launched in 2015 the Capital Markets Union (CMU) initiative with the objective to enable EU financial markets to play a more important role in the financing of the European economy.

More than four years after CMU was launched, it is far from being completed, with only few legislations implemented to-date, and of which some do not produce the expected results. With the UK, so far the main financial center of the Union, leaving the EU, we believe that it is time for a deepening and intensification of the **reflections around the role of EU financial markets in the financing of the economy, and for a more effective adaptation of the EU regulatory and supervisory framework.**

Since the beginning of the CMU project, AMAFI has closely followed discussions on the legislations proposed by the EC. In particular, we have contributed to the following workstreams:

- ✓ **On CMU** : AMAFI / 15-19 ; 15-28 ; 16-08 ; 17-24 ;
- ✓ **On the Prospectus Directive** : AMAFI / 15-27 ; 16-14 ; 17-61 ; 18-14 ; 18-74 ;
- ✓ **On Simple Transparent and Standardized Securitization** : AMAFI / 15-29 ;
- ✓ **On the ESAs review** : AMAFI / 17-35 ; 17-77 ; 18-42 ; 18-43 ;
- ✓ **On SMEs growth markets** : AMAFI / 18-12 ; 18-36 ; 18-44 ;
- ✓ **On sustainable finance** : AMAFI / 18-29 ; 18-41 ; 19-22 ; 19-44 ;
- ✓ **On the investment firm review**: AMAFI / 18-13 ; 18-25 ; 18-45 ; 18-65.

Overall, we consider it is necessary **to move from sectoral measures to a more holistic vision focusing on the benefits financial markets could bring to society**. As suggested in our answer to the EC's consultation on the CMU mid-term review, AMAFI is in favour of the creation of a Committee of Wise Men in order to take a step back and consider the role of financial markets as a whole.

Going forward, AMAFI considers it is important to **find a balance between**, on the one hand, **wholesale markets requiring a pan-European regulatory and supervisory approach** and, on the other hand, **local markets whose functioning requires more proportionality with regards to the implementation of EU legislations and a preponderant role of NCAs**.

In light of the key issues at stake for its members, we are keen to contribute to the ongoing reflections around the future of CMU in order for **EU financial markets to finance EU-27 economies in a more effective and autonomous way.**

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More specifically, we consider CMU 2.0 should focus on delivering around the three main functions of financial markets: **(i) mobilization of savings and channelization to projects, (ii) hedging against risks and (iii) providing liquidity**.

In this paper, AMAFI highlights the issues for which it considers that reforms are needed in order for CMU 2.0 to deliver on the three main functions of financial markets.

1. Strengthening the EU-27 financial markets capacity to finance its economy autonomously

➢ Reflecting on the current structure of EU financial markets

AMAFI would like to highlight strong concerns from its members about the current structure of EU financial markets and potential damaging repercussions if they continue developing in the same manner as they have done in recent years. Indeed, European markets are increasingly characterised by a **reduced diversity of market actors, the growth of passive management of assets, the growing lack of liquidity of assets classes, the reduction in number and weight of contrarian investors, replaced quasi exclusively by the interventions of the ECB, and the constraint on investors' and intermediaries' profitability imposed by the low interest rate environment; all factors contributing to the increase of pro-cyclical risks.** With this in mind, we consider EU authorities should initiate **a reflection on le role of regulation in making financial markets more efficient, more robust and more resilient.**

➢ Generating positive externalities across EU's financial places

With the City expected soon to be outside of the EU-27, **it will be critical to ensure the development and attractiveness of existing EU-27 financial places while respecting their specificities.** What is at stake here is to **rebuild in the Union, across different financial centers and despite their fragmentation, the positive externalities that used to result from the concentration of financial services providers in London.** To that end, the various elements necessary for the building-up of such environments will have to be considered carefully with the objectives to notably **(i) reduce internal barriers within the EU** (such as the EPTF barriers) and **harmonise as much as possible the fiscal and legal frameworks** applicable to financial services across member states, **(ii) further develop highly specialized and qualified staff** as well as **(iii) concentrate specialized firms with the objective *in fine* to increase competition, to stimulate innovations and ultimately to deliver better services quality.**

In that context, AMAFI considers that a first step would be to encourage the development of the EU trading capacity in order to maintain European issuers' main liquidity pools located within the EU-27. This would provide the necessary infrastructure for financial markets to operate efficiently and in a transparent way.

➢ Ensuring that equivalence regime with third-countries effectively contributes to the protection of EU-27 investors and to the integrity of EU-27 markets...

Considering the future relationship between the EU and the UK, AMAFI would like to emphasize that **equivalent decisions should be taken on the ground of a text-by-text analysis, be subject to a regular review and not only be outcome based**. This is crucial for financial markets to operate efficiently, to protect consumers and to preserve financial stability. In light of ESMA's expertise of financial markets, regulations and practices, it should play a key role in leading on the equivalence process and monitoring.

This way, **the future framework can contribute to the creation of a new beneficial relationship between EU and UK financial markets where both parties would remain sovereign in granting access to their respective domestic markets.** Finally, ESMA should also play a central role in terms of coordination when it comes to the supervision of firms' outsourcing, delegation and material risk transfer arrangements to entities based in third countries.

Notwithstanding the above argumentation, **AMAFI also considers that national regimes under the close supervision of NCAs play a very important role in the efficiency of local markets and their specificities should be carefully considered.**

- **... while maintaining access to global interdealer liquidity pools for EU-27 liquidity providers**

With its main financial center leaving the EU, **a priority for EU-27 financial market dealers will be to continue to have access to other major liquidity pools to continue serving their clients in the same way as they used to.** On a global basis, while the **access to issuers and investors is legitimately subject to the equivalence regime of each regulatory zone**, it will be key to ensure that **financial market dealers keep having access to the largest liquidity pools across the world**.

- **Enabling the securitization market to take-off**

The STS securitisation Regulation which entered into force in January 2018 is far from producing the expected results. On the one hand **the legislation has created too many constraints resulting from too heavy prudential requirements and on the other hand it does not lay the foundations to build-up a true European securitization market.** Financial markets cannot satisfy all companies' financing needs. Thus, it is vital with securitisation, to set up a process in recharging banks capital and funding capacity.

Indeed, the European ecosystem appears less favourable than the one in the US where securitisation plays a central role. One key difference revolves around the establishment of Government Sponsored Enterprises (GSEs) in the US which provide a rather explicit guarantee that enables to remove extremely important amounts of residential loans from banks balance sheets through the securitization process. **AMAFI considers the creation of similar GSEs, together with efforts to limit divergences in member states bankruptcy laws, as necessary pre-conditions for the securitization market to take-off in Europe.**

2. Supporting the uptake of technological innovation in the EU financial sector

- **Developing financial technologies**

The development and use of FinTech (e.g. DLT, AI) will play an important role in supporting financial market activities and in enabling the EU-27 to finance its economy autonomously.

With regards to data, reflexions should focus on their use (e.g. pooling of data to create indices) as well as on their storage (e.g. cloud services, data storage facilities) and to what extent they should be located in the EU. While AMAFI is rather supportive of the approach taken by the RGPD, it also considers that the EU-27 might suffer from a lack of competitiveness with other countries like the US which are not subject to such high standards.

We also consider the development of ICOs as particularly promising with tokens representing an opportunity **for banks and investment firms to help their clients develop new ways of raising funds to finance their growth** *(AMAFI / 19-43).* Nevertheless, it appears necessary to ensure that the development of tokens is subject to a secure framework and does not create major financial crisis or scandal which would end up with a loss of public confidence in financial markets. **Going forward, it will be key to find a good balance between innovation and investor protection.**

- **Encouraging the development of European champions**

As financial technologies such as AI, DLT and cloud services are still at an early stage of development, it appears crucial, both in terms of competitiveness with the US and Asia as well as of EU sovereignty, that **upcoming legislations encourage the development of EU FinTech champions in order for EU financial markets to become more competitive**. EU financial institutions should not become over-dependent on financial technologies from third country providers.

3. Linking-up financing supplies and demands

- **Supporting the development of patient capital/investors**

AMAFI considers it is necessary for future reforms to facilitate the development of patient investors which would allocate capital to long term projects. We believe pension funds have an important role to play especially for infrastructure and sustainable finance investments. **The creation of pension products that have advantageous tax treatment could be an option.** While we understand this solution has a significant tax dimension, hence largely depends on each member states fiscal strategy, we consider that the Union has a role to play through the current EU discussions aiming to move decisions on tax related issues concerning savings allocation from unanimity to qualified majority.

- **More generally, reforming the existing EU taxation regime on savings**

Another important issue revolves around the allocation of savings towards long term investment. AMAFI considers it is necessary **to amend and harmonize existing national legislations dealing with taxation on savings** in order to incentivize the allocation of savings towards more long term and risky investments. Besides, we believe future regulatory reforms should aim to **facilitate the development of patient investors and in particular pension funds** as they would also contribute to the financing of more long term and risky projects.

- **Promoting the creation of sustainable finance**

The development of sustainable finance is of the utmost importance in the collective effort to mitigate climate change.

With this in mind, **AMAFI is supportive of ongoing discussions on sustainable finance legislations and in particular around the creation of an EU taxonomy and the integration of ESG criteria in MiFID2 which should result in providing investors with more certainty around the sustainable component of their investments underlying activities** *(AMAFI / 19-44)***.** Nevertheless, we believe the building-up of an EU taxonomy should be progressive and limited to products with an environmental purpose. Similarly, the integration of ESG criteria should be principle based and subject to a minimum 18 month implementation period.

- **Amending MiFID2 provisions on SME research financing**

MiFID2 and in particular Article 13 of the Commission Delegated Directive (EU) 2017/593 has modified the economic model of financial analysis for equity markets by de facto prohibiting the former and largely used “bundled model”. Henceforth, research has to be paid by asset management companies independent of the transactions they carried out with their brokers, at least when acting on behalf of client portfolios.

There is a large consensus among issuers, asset management companies and research providers that, given the new rules, the total amount paid for research has dramatically diminished and will likely continue to fall in the coming years and accordingly the supply of research. This particularly impacts the supply of research for SMEs because research providers are no longer able to finance research on SMEs in a context where cross-subsidization is not possible. **As there is no evidence that a new economic model will emerge, MiFID II provisions already result in a severe reduction in the availability of research on SMEs. These provisions should be reviewed as a matter of urgency, as they impact the attractiveness and liquidity of listed SMEs, and ultimately their access to capital.**

About AMAFI

Association française des marchés financiers (AMAFI) *is the trade organisation working at national, European and international levels to represent financial market participants in France. It acts on behalf of credit institutions, investment firms and trading and post-trade infrastructures, regardless of where they operate or where their clients or counterparties are located. AMAFI's members operate for their own account or for clients in different segments, particularly organised and over-the-counter markets for equities, fixed-income products and derivatives, including commodities. Nearly one-third of members are subsidiaries or branches of non-French institutions.*