ICI Global's response to the EU Commission's consultation on the CMU mid-term review

ICI Global[1] welcomes the European Commission's mid-term review of the Capital Markets Union (CMU). As recognised by the Commission, the CMU is a plan to mobilise capital and aims to tackle investment shortages head-on by increasing and diversifying the funding sources for Europe's businesses and long-term projects. The Commission's overall goal for the CMU is to create opportunities for investors, connect finance to the wider economy and foster a more resilient financial system with deeper integration and more competition. By linking savings and growth, the CMU will offer new opportunities for savers and investors.[2]

We strongly support the Commission's stated objectives for the CMU.[3] We urge the Commission to continue to vigorously pursue this initiative. Our responses to specific questions in the mid-term review consultation highlight the following priority actions for the regulated fund industry:

- Removal of barriers to the cross-border distribution of investment funds, including: (i) developing a harmonised cross-border marketing regime for UCITS; (ii) simplifying and converging authorisation and notification requirements; and (iii) eliminating other impediments[4] (see also question F);

- Development of a single pan-EU private placement regime for professional investors that would remove the inefficiency and significant complexity of complying with individual Member State regimes. A pan-EU regime would deepen, integrate and diversify funding sources for the EU's capital markets and build on the Commission's longstanding work[5] (see also question A);

- Development of a pan-EU personal pension product (PEPP) that supports cross-border pooling, management and administration of assets to help build adequate retirement income and better accommodate a mobile EU workforce[6] (see also question D);

As the Commission proceeds with its work to increase and diversify EU funding sources, it must be mindful that its other policy initiatives impacting participants in the EU's capital markets must be calibrated to reflect the fundamental differences between bank-based financing and market-based financing.

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[1] ICI Global carries out the international work of the Investment Company Institute, serving a fund membership that includes regulated funds publicly offered to investors in jurisdictions worldwide, with combined assets of US$20.5 trillion. ICI Global seeks to advance the common interests and promote public understanding of regulated investment funds, their managers, and investors. Its policy agenda focuses on issues of significance to funds in the areas of financial stability, cross-border regulation, market structure, and pension provision. ICI Global has offices in London, Hong Kong, and Washington, DC.

[2] *See* European Commission, Press Release, Capital Markets Union: An Action Plan to boost business funding and investment financing," 30 September 2015, available at http://europa.eu/rapid/press-release_IP-15-5731_en.htm; European Commission, Capital Markets Union Unlocking funding for Europe's growth, available at http://ec.europa.eu/finance/capital-markets-union/index_en.htm.

[3] *See, e.g.,* ICI Global response to the European Commission's Green Paper on "Building a Capital Markets Union", available from https://www.iciglobal.org/pdf/28990.pdf.

[4] *See also* ICI Global response to the EU Commission's Consultation on Barriers to the Cross-Border Distribution of Funds in the EU, available from https://www.iciglobal.org/pdf/30285.pdf.

[5] *See also* ICI Global response to EU Commission's Call for Evidence on the EU Regulatory Framework for Financial Services, available from https://www.iciglobal.org/pdf/29677.pdf.

[6] *See also* ICI Global response to the European Commission's Consultation on a potential EU personal pension framework, available from https://ec.europa.eu/eusurvey/publication/personal-pension-framework-2016-stakeholders?surveylanguage=en.

Failure to do so risks undermining the Commission's ability to deliver on its stated objectives for the CMU. Below, we offer two examples.

- *Review of the EU Macroprudential Policy Framework* – we recommend changes to the European Systemic Risk Board (ESRB), including: (i) reconstituting it to give a greater role to securities and insurance regulators; (ii) providing it with responsibility for systemic risk monitoring across the EU financial system; and (iii) "broadening and deepening" its analytical resources to facilitate such monitoring including in non-bank sectors. We believe that, if potential risks to EU financial stability outside the banking sector are identified, it then should be up to the relevant ESA (ESMA regarding capital markets and asset management) in coordination with national regulators or up to regulators in each Member State, using their existing toolkits, or developing new regulatory tools, to intervene;

- *Design of a new Prudential Regime for Investment Firms* – we recommend that: (i) a firm's activities be the focus of any prudential requirements; and (ii) prudential requirements calibrated to address risks posed by an asset manager, should mean risks to the firm's balance sheet and not market or other risks associated with the assets of a regulated fund or other clients of the manager.

The EU has reaffirmed its support for the critical role played by capital markets in the economy.[7] The Capital Markets Union is even more important now than when it was initiated by the Commission in 2012, given the potential far reaching impacts of geopolitical changes on financial markets, including Brexit, on the funds industry. Completing the CMU is imperative to strengthen and deepen capital markets both within the EU27 and outside, in turn providing commensurate benefits to fund investors. We strongly encourage the Commission to pursue the priority objectives that we have identified in the CMU action plan, while ensuring that other policy initiatives do not inadvertently weaken or jeopardise efforts to boost EU funding and investment financing (e.g. the review of the EU Macroprudential Policy Framework and the design of a new Prudential Review for Investment Firms).

[7] Joint Declaration on the EU's legislative priorities for 2017, available from https://ec.europa.eu/commission/publications/joint-declaration-eus-legislative-priorities-2017_en

Response to individual questions submitted via the online questionnaire

A. Financing for innovation, start-ups and non-listed companies

Are there additional actions that can contribute to fostering the financing for innovation, start-ups and non-listed companies? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

We recommend that the Commission draws on the best practice that it has identified to develop a single pan-EU private placement regime for professional investors with the following elements:

- Harmonised, clear and well-defined definitions (*e.g.* the types and sophistication of investors, the activity of "marketing", and general and reverse solicitation);
- Harmonised disclosure requirements that are calibrated to the sophistication of investors, with minimal requirements imposed on limited placements to sophisticated investors;
- A framework that supports the "resale" of privately placed securities.

A single pan-EU private placement regime would remove the inefficiency and significant complexity of Member State regimes (e.g. fragmentation, lack of size and depth, high cost, information barriers, and lack of standardisation) and support the Commission's efforts to deepen, diversify and integrate the EU's capital markets

C. Investing for long term, infrastructure and sustainable investment

Are there additional actions that can contribute to fostering long-term, infrastructure and sustainable investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

We urge the Commission to continue to vigorously pursue the following priority actions:

- Develop a pan-EU personal pension product (see also question D);
- Conclude legislation to create a framework for simple, transparent and standardised ("STS") securitisations that is attractive to investors; (see also question E);
- Remove barriers to the cross-border distribution of investment funds (see also question F).

As the Commission proceeds with its work to increase and diversify EU funding sources under the CMU, it must be mindful that its other policy initiatives impacting participants in the EU's capital markets must be calibrated to reflect the fundamental differences between bank-based financing and market-based financing. While safety and soundness is a hallmark of banking regulation, such an approach is wholly inappropriate to capital markets and asset management where, for example, investment funds and asset managers undertake evaluations of market and investment risk on behalf of their clients. Stated another way, the Commission must avoid taking a bank-oriented approach to regulation outside of banking. Failure to do so risks undermining the Commission's ability to deliver on its stated objectives for the CMU. Overleaf, we offer two examples.

(i) Review of the EU Macroprudential Policy Framework

The Commission is currently conducting a review of the EU macroprudential policy framework. In a letter to the Commission last October, we made recommendations for how the bank-dominated European Systemic Risk Board (ESRB) could be reconstituted to give a greater role to securities and insurance regulators.[8] We support the ESRB having responsibility for systemic risk monitoring across the EU financial system, as well as "broadening and deepening" the ESRB's analytical resources to facilitate such monitoring including in non-bank sectors. This however is altogether different from expanding the macro-prudential framework beyond banking—an approach that we strongly oppose. Such an approach is wholly inappropriate for capital markets and asset management, where a fundamental underlying premise is that a range of participants – including fund managers, individual investors, and institutions – make their own calculations about the level of investment risk they are willing to bear. Respecting this difference is essential if the Commission is to achieve the goal of better channelling capital to more companies, including SMEs. If potential risks to EU financial stability outside the banking sector are identified, it then should be up to the relevant ESA (ESMA regarding capital markets and asset management) in coordination with national regulators or up to regulators in each Member State, using their existing toolkits, or developing new regulatory tools, to intervene.

(ii) Design of a new Prudential Regime for Investment Firms

The Commission also has initiated an effort to design a new prudential regime for investment firms, one that is specifically tailored to the risks that these firms present. As directed by the Commission, the European Banking Authority ("EBA") is currently working on a proposal outlining the "appropriate design and calibration of all aspects of a new prudential regime" for investment firms.[9] In a February letter to the EBA, we voiced concern that some aspects of the proposal appear too rooted in banking and do not appropriately reflect the business and operations of asset managers. For example, we took strong exception to the suggestion in the EBA's discussion paper that size could equate to systemic status in the case of an asset manager and recommended that the firm's activities be the focus of any prudential requirements. Further, prudential requirements calibrated to address risks posed by an asset manager should mean risks to the firm's balance sheet and not market or other risks associated with the assets of a regulated fund or other clients of the manager. Such risks belong to the clients, who knowingly bear them.

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[8] *See* ICI Global response to the EU Commission's Consultation on the Review of the EU Macroprudential Policy Framework, available from https://www.iciglobal.org/pdf/16_icig_eu_macroprudential_framework_questions.pdf

[9] EBA, Discussion Paper, *Designing a new prudential regime for investment firms*, EBA/DP/2016/02 (4 November 2016), available from https://www.eba.europa.eu/documents/10180/1647446/Discussion+Paper+on+a+new+prudential+regime+for+Investment+Firms+%28EBA-DP-2016-02%29.pdf

D. Fostering retail investment and innovation

Are there additional actions that can contribute to fostering retail investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

(i) We welcome the Commission's commitment to bring forward a legislative proposal for a pan-EU personal pension product (PEPP).[10] As we indicated in our response to the Commission's Survey on a potential EU personal pension framework, we generally support the proposal recommended by the European Insurance and Occupational Pensions Authority (EIOPA) to the Commission, which combines a set of standard requirements with flexible features. More specifically, we recommend that the proposal has the following elements:

- Some flexibility in product design (e.g. pay-out requirements) to enable providers to create – through competitive incentives – products that are tailored to customers' needs and specific member states' requirements;
- Standardised and simple disclosure that lays out the product's key features to ensure consumers understand the PEPP and its purpose;
- Flexibility in distribution, including through online means and advised and non-advised channels (e.g. for consumers whom are fully served by a default lifecycle product), to accommodate the diversity of customer preferences;
- Measures to address cross-border impediments, including reporting mechanisms to facilitate compliance with different jurisdictions' tax treatment of personal retirement savings and ensuring that a PEPP receives at least the same tax treatment as that provided to comparable personal pension products offered in each Member State;
- Incentives to overcome cultural reluctance towards the use of personal pension products.

(ii) We support the Commission's desire to provide effective access to capital markets for EU retail investors. We believe the Commission's action plan should contain the following high-level elements:

- Removal of the impediments and barriers for the cross-border distribution of UCITS and the development of a harmonised marketing regime, to complete the internal market passport, thereby increasing choice and enabling retail investors to benefit from cost efficiencies derived from the management of pooled fund assets (see also question F); and
- Regulatory approaches to accommodate and encourage the adoption of digital technology and the electronic delivery of information – to foster innovation and offer advantages to retail fund investors, such as easier access to information and more efficient means of advice and investment (e.g. automated advice, online accounts, electronic KYC/AML checks etc.), including to support the Commission's broader retail financial services agenda.

10 *See* European Commission - Fact Sheet, Public Consultation on the Capital Markets Union Mid-term review (20 Jan. 2017), available from http://europa.eu/rapid/press-release_MEMO-17-116_en.htm.

E. Strengthening banking capacity to support the wider economy

Are there additional actions that can contribute to strengthening banking capacity to support the wider economy? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

We have supported efforts by the co-legislators to revive the securitisation market in the EU, including, but not limited to, the development of an EU framework for simple, transparent and standardised ("STS") securitisations. In reaching final agreement, we believe the co-legislators should seek to encourage strong supply and demand for STS securitisations, by ensuring they remain attractive to both originators and investors.

F. Facilitating cross-border investment

Are there additional actions that can contribute to fostering long-term, infrastructure and sustainable investment? Please propose complementary policy measures, explain their advantages, and illustrate any foreseeable challenges to their implementation.

We welcome the Commission's commitment to take forward work to remove barriers to the cross-border distribution of investment funds. Member States' efforts to promote common understanding and convergence in national rules and practice, particularly concerning marketing requirements, may result in the partial remove of some barriers. To achieve the goals of the CMU, including providing investors with efficient access to cross-border funds, we recommend that the Commission pursues initiatives to achieve the following changes to the cross-border operation and distribution of regulated funds across the internal market:

- Harmonising UCITS marketing rules, including definitions of "pre-marketing", to eliminate duplication, divergence and conflict among various Member State requirements;

- Removing Member State rules that impede the establishment of UCITS funds by management companies in other Member States;

- Converging and simplifying the authorisation and notification process to minimise delays and costs e.g., shorten and limit review times, and expedited procedures for minor changes or UCITS that are "clones" of existing authorised UCITS;

- Harmonising the electronic transmission and filing of updates or amendments to registration documents, to enable the single market passport to be obtained through a single home Member State filing, akin to the MIFID services passport;

- Introducing a passport to enable a depositary to act for UCITS funds across the single market, regardless of the Member State in which the fund is established. A depositary passport would increase competition, provide funds with a broader range of depositaries and may reduce operational costs;

- Converging Know Your Customer (KYC) requirements, including supporting the use of electronic identity verification, and facilitating cross-border data sharing between distributors and funds to reduce costs and operational complexities and better accommodate cross-border distribution, while ensuring a strong anti-money laundering (AML) framework;

- Actively encouraging digitalisation, including through the adoption of regulatory approaches for the distribution of regulated funds through technology and the electronic delivery of information to investors;
- Adopting the OECD's TRACE implementation package for withholding tax relief generally and encouraging Member States to provide treaty relief for funds by implementing the CIV Report recommendations in their treaties.