

A Capital Markets Union: Integration of Capital Markets in the European Union Action plan update

October 2015



Earlier this month, the European Commission (EC) released its Action Plan for developing a Capital Markets Union (CMU) in Europe. The plan is comprised of more than 30 specific actions which represent an important initiative for promoting integrated capital markets in the EU. Like the EC's initial Green Paper on the subject, the CMU Action Plan has generated a significant response from market players and groups representing the finance industry. Chris Cummings, Chief Executive of TheCityUK, called the plan "a positive step in realising the ambition to strengthen Europe's capital markets and make it quicker, easier and cheaper for businesses – in particular for Europe's higher growth companies – to access funding."¹ Alexander Schindler, President of the European Fund and Asset Management Association (EFAMA), has high hopes for the plan. "This should also serve the purpose of addressing, sooner rather than later, we hope, the current overlapping requirements that are either not fully consistent with each other, or which inadvertently create an unlevel playing field amongst financial sectors,"² he said.

Early reforms are focused on institutions

The CMU is a medium-term project, but with some important early initiatives. While the plan will focus on consumers at a later stage, current initiatives, like the proposed Securitisation Regulation, are aimed at institutions. According to the EC, if EU securitisations could be safely revived to pre-crisis average issuance levels, banks would be able to provide an additional EUR 100 billion of credit to the private sector.

A recent PwC report on CMU found that from 2001 to 2008, securitisation issuance grew by 36.1%, but decreased by 13.4% on an average annual basis from 2009 until 2014.³ Our report recognises that, in addition to being the main current provider of corporate finance, banks play an important role in capital markets, which means that initiatives that could have unintended negative consequences need to be broached carefully. Regulations pertaining to capital requirements can

dis-incentivise investors from buying securitised products. The EC recognised this in the action plan, and has therefore taken steps to deal with it via a proposal for 'simple, transparent and standardised (STS) securitisations' and a revision of the calibration of capital for banks and insurers.

The plan details other immediate measures to be taken by the end of 2015, including:

- a recalibration of Solvency II for infrastructure and European Long-Term Investment Funds (ELTIFs), which would involve lowering capital charges;
 - a review of European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) regulations to consider whether targeted changes to these regulations could boost the take up of these investment funds; and
 - a proposed Green Paper on Retail Financial Services.
- a call for evidence on the cumulative impact of the financial reform in order to identify possible inconsistencies, incoherence and gaps in financial rules, as well as unnecessary regulatory burdens and factors negatively affecting long-term investment and growth;
 - a consultation on the EU framework for covered bonds and similar structures for SME loans in order to create an EU covered bond framework;

¹ TheCityUK's press release, Chris Cummings, Chief Executive, TheCityUK responds to the European Commission's Action Plan on Capital Market Union, published 30/09/2015

² EFAMA's press release, EFAMA reiterates support to a Capital Market Union which will deepen the Single Market and Investor Protection, published 30/09/2015

³ PwC, Capital Market Union: Integration of Capital Markets in the European Union, September 2015 (www.pwc.com/gx/en/banking-capital-markets/pdf/cmu-report-sept-2015.pdf)

The building blocks for a CMU have been identified

The EC Action Plan addresses additional observations identified in the PwC report on CMU⁴:

- First, improving cross-border distribution of capital: this is of the utmost importance as it will expand choice for investors and companies seeking funding. The EC Action Plan explicitly lists 'the removal of national barriers to cross-border investment' as one of its planned actions. Specifically, by 2017 the EC will pursue initiatives to improve market infrastructure for cross-border investing, take targeted action on securities ownership rules and third-party effects of assignment of claims and take measures to remove the remaining Giovannini barriers.⁵
- Second, addressing the asymmetry of information between investors and borrowers across the EU: the CMU Action Plan tackles this issue by proposing measures that include strengthening feedback given by banks that decline SME credit applications (by Q2 2016), mapping out existing local or national support and advisory capacities across the EU to promote best practices (by 2017), and investigating how to develop or support pan-European information systems (by 2017).
- Third, promoting diversified sources of financing to reduce dependency on bank loans: the EC has made 'promoting innovative forms of corporate financing' a priority for 2016. Current goals include commissioning a report on crowdfunding, developing a coordinated approach to loan origination by funds and assessing the case for a future EU framework on loan origination by funds. In addition, the EC has gone further in fostering retail and institutional investment by including in its goals an assessment of the case for a policy framework to establish European personal pensions by the end 2016. This could create another pool of resources for financing SMEs at a cross-border level.

Additional work will be required

While the CMU Action Plan is an important step forward on the path to integrated capital markets in Europe, additional work is still needed in order to thoroughly identify the main challenges that lie ahead and to target specific issues that should be addressed. In this vein, the EC has proactively called for additional consultations and research to identify possible obstacles to a CMU. Specifically, in 2016, the EC intends to release a report on national barriers to the free movement of capital. The following year, the EC plans to conduct an additional study on discriminatory tax obstacles for cross-border pension funds and life insurance.

The CMU Action Plan is the first initiative in a long-term plan designed to build confidence and momentum in the growth and integration of Europe's markets. The aim is for European businesses to have more options for funding, allowing them access to bigger pools of capital, and to draw new funding from outside the EU. The financial system within Europe should become more resilient as reliance on banks is reduced. For individual savers and investors, those saving for old age will have more pension investment choices. A successful CMU could bolster the economies of each of the 28 member states, but to achieve this, additional barriers related to cultural issues and the asymmetry of information will have to be addressed.

For further information, please contact:

Brian Polk
PwC UK
+44 (0) 20 7804 8020
brian.polk@uk.pwc.com

⁴ PwC, Capital Market Union: Integration of Capital Markets in the European Union, September 2015 (www.pwc.com/gx/en/banking-capital-markets/pdf/cmu-report-sept-2015.pdf)

⁵ The Giovannini Group was a group of financial market experts, formed in 1996 to advise the European Commission on financial market issues. The Group focused on identifying inefficiencies and barriers to integration in EU financial markets.

www.pwc.com/financialservices

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 208,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwC does not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2015 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.