The European Federation of Financial Services Users
Fédération Européenne des Usagers des Services Financiers

Better Finance Response to the European Commission Consultation "Building a Capital Markets Union"

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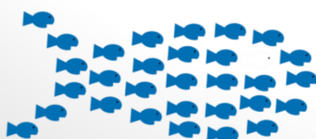

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Introduction

Better Finance is very supportive of the new Commission's major initiative on the Capital Markets Union (CMU) so that more citizens will stand to benefit from a real single market for savings and investment services.

To this end, Better Finance released an ad-hoc Position Paper on the Capital Markets Union[1] that serves as a basis for this reply to the CMU consultation from the European Commission. Our paper has been presented to and discussed with key policymakers within the Commission.

Better Finance believes it is important for the CMU and retail market integration not to be treated as separate initiatives. Both should support each other. More efficient retail markets result in a more efficient transmission of capital through the system to the benefit of the real economy. Likewise, improving the efficiency of capital markets and preventing dangerous behaviour in wholesale and institutional markets from emerging and being transmitted throughout the supply chain, results in safer financial products at a better value for households and the real economy.

Executive Summary

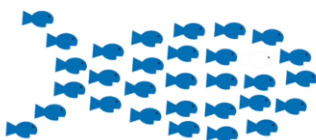
Better Finance, the European Federation of Financial Services Users, welcomes the European Commission initiative and the Green Paper on Building a Capital Markets Union (CMU). Indeed - if properly articulated - it would help the European economy to revive growth and jobs.

We fully agree that:

- Europe needs to "find ways of linking investors and savers with growth",
- the cost of capital needs to be lowered, in particular for SMEs ,
- "capital markets need to play a larger role in channelling financing to the economy",
- Europe needs to "boost the flow of institutional and retail investment into capital markets".

However, Better Finance is concerned that only one page of the Green Paper is devoted to individual ("retail") investors, and that there is nothing for them in the short-term priorities, although EU households are the main source of long-term financing for the real economy; and despite the severely damaged investors' trust as measured by the EU Commission itself.

[1] Available here.



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Direct involvement of individual investors in capital markets

In particular, the Paper does not include any analysis of the decline of direct individual ownership of securities (shares and bonds) in Europe, nor any proposal that would again enable EU individual investors to invest more directly into capital markets, the way they did a few decades ago, and to revive an equity culture in Europe. Better Finance designed such proposals (section two: how to make capital markets – shares and bonds – more accessible and attractive again to individual investors), and dispels inaccurate judgements of EU individual investors as supposedly being shorter-term oriented and more risk averse than other investors (section one: The predominant role of individual investors in the long term financing of the economy).

Such proposals include (full list on page 23):

- a single and effective market in the EU for shares ownership, emphasizing shareholders' rights and engagement
- a level-paying field for shares and bonds versus "packaged" products in "retail" distribution
- easily accessible and transparent capital markets for individual investors and real economy issuers, SMEs in particular.

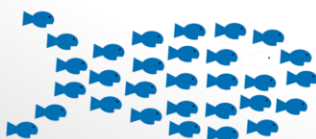
Indirect ("intermediated") involvement of individual investors in capital markets

Investor protection measures should also be taken to ensure that "institutional" investments – which, on the whole, merely package EU households' savings while increasingly leaving investment risks to the savers – do actually provide transparent and decent returns to EU long term savers, net of costs and fees. A future CMU has to improve trust, comparability and consumer satisfaction in investment products. Better Finance made detailed proposals to this end (section 3: how to better focus on long term capital markets, on the real economy and on SMEs in particular).

Such proposals include (full list on page 28):

- For EU citizens and supervisors to know the actual long term returns and total fees of all "packaged" investment products, including, most importantly, pension products, either insurance regulated or not;
- Simplify, standardize and streamline the bewildering and costly range of product offerings (funds alone are 4 times more numerous and 8 times smaller than in the US);
- Tax financial transactions (forex, derivatives, high frequency trading) but not real economy investments (non-financial equities and corporate bonds).

Finally, supervision and enforcement – both public and private – of investor protection rules must become more effective and harmonized throughout the EU to restore the damaged investors' trust in the long run.



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The CMU initiative will be judged on how it improves the economic well-being of households and real economy firms in the EU. To do this, it must enhance the efficiency and economic utility of financial intermediation and asset allocation in the EU's wholesale and institutional markets.

In other words, for Better Finance the primary goal of the CMU is to *ensure that capital gets from where it is, to where it is needed, in the **most economically and socially productive way**.*

This is not the case now.

Making the CMU work for the real economy and society requires a renewed focus on the three primary functions of financial markets:

- Efficient allocation of resources from providers of capital to the users of capital - the asset allocation function;
- Efficient financial intermediation – that is the efficient transforming of deposits and savings into equity and loans for firms and households; and
- Effective and efficient risk management – the insurance function which allows households and firms to protect themselves against economic risks.

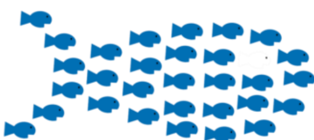
Structural reforms and realignment of interests in the wholesale and institutional markets are needed. The CMU initiative should also involve individual investors and savers, not only professional ones, and promote financial markets that are safe and resilient, efficient, fair, transparent, well-regulated and easily accessible to individual investors[2]. Specifically, measures are needed to address the major inefficiencies in the asset management, life insurance and pension industries. As shown by the 'Consumer Scoreboard', there is a persistent and pronounced distrust of the investment and pension industries in Europe[3].

We very much support the promotion of alternative, socially useful innovations to meet the needs of households and the real economy. However, if we want to meet the primary goal of the CMU (see above) we need to tackle the existing inefficiencies in established markets as well as promoting innovation. Crowdfunding (in particular crowd lending and equity), for instance, is an important aspect of innovation of capital markets and forms part of it.

The Green Paper tends to be rather ambitious in terms of the range of different interest it wishes to address and the different users it wishes to be relevant for. We believe that the proposals taken up in the Green Paper, as a form of financial intermediation, can only serve the interests of a limited grouping of potential users of capital.

[2] «*It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors*" – Steven Maijoor, chair of ESMA, December 2014.

[3] European Commission 10th Consumer Scoreboard, June 2014



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For instance, the Green Paper identifies SMEs in general as a priority. This fails to take into account the fact that there are substantial differences in the character and needs of the wide variety of different SMEs that operate in the European economy. This issue is clearly reflected in the definition of SMEs that is expressed in terms of size: according to the definition SMEs in terms of employment can range in size from 0 to 249 employees.

We believe that capital markets will not be able to meet the financing needs of micro enterprises, which constitute 92% of the total number of enterprises in Europe. These enterprises will continue to mainly rely either on their internal funds, on bank financing, or gradually on the increased use of alternative sources of financing that are experiencing significant growth in the EU, e.g. crowdfunding.

It is clear that much more consideration should be given to the broad variety of SMEs in order to identify their particular funding needs. As far as the Green Paper is concerned, BETTER FINANCE believes that it should be recognized that only a limited number of the larger SMEs are likely to benefit from a Capital Markets Union that excludes crowdfunding.

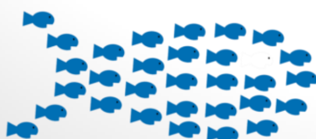
1) ***Beyond the five priority areas identified for short term action, what other areas should be prioritised?***

Most unfortunately, none of these «five priority areas» are directly relevant to individual (so called "retail"- a marketing terminology) savers and investors, i.e. the majority of EU citizens (with the exception of the much needed improvement to the «summary prospectus» for shares and bonds).

However, as recognised upfront in the EC Green Paper on the long term financing of the European economy, households are the main source for this long term financing. Ignoring them in the five priority areas for short term action is a recipe for failure, since addressing their current disturbingly low confidence in capital markets and investment intermediaries will prove to be crucial. The EU must immediately improve individual investor protection to enhance their confidence in capital markets.

"The CMU will not be successful if its design focuses solely on financial institutions' needs. It must also add value to investors. Diversifying the funding of our economy can only be achieved if investors have an incentive to take part in this initiative."

"It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors."



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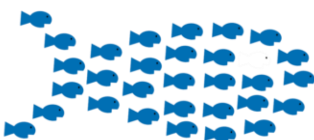
“The protection of investors should play a major role in building the CMU.”[4]

Short term investor protection measures to enhance individual investor participation in the long term financing of the real economy and their participation in the move towards a capital markets union include measures to:

- Improve their indirect access via intermediated – “packaged” products – such as deposits, investment funds, life insurance and pension funds, which currently make up for 74 % of EU households financial savings.
- Improve their direct access to capital markets via shares and bonds which currently make up 22% of EU households’ financial savings. As a matter of fact, 62% of EU households’ financial savings are typically long term: pension funds, life insurance, shares, funds and bonds. In addition, in the EU, financial savings are often not the biggest part of households’ savings: when one takes property assets into account as well, the long term orientation of individuals is even more obvious, with probably at least 90% of their total savings in long term investments. This does not come as a surprise since individual investors have predominantly long term goals: retirement, home purchase, children’s education, etc.

[4] Steven Maijoor’s – ESMA Chair – speech “Investor Protection and an integrated EU-Capital Market” at the DSW/ Better Finance International Conference “Shareholder Rights in Europe 2020”, 9 December 2014.



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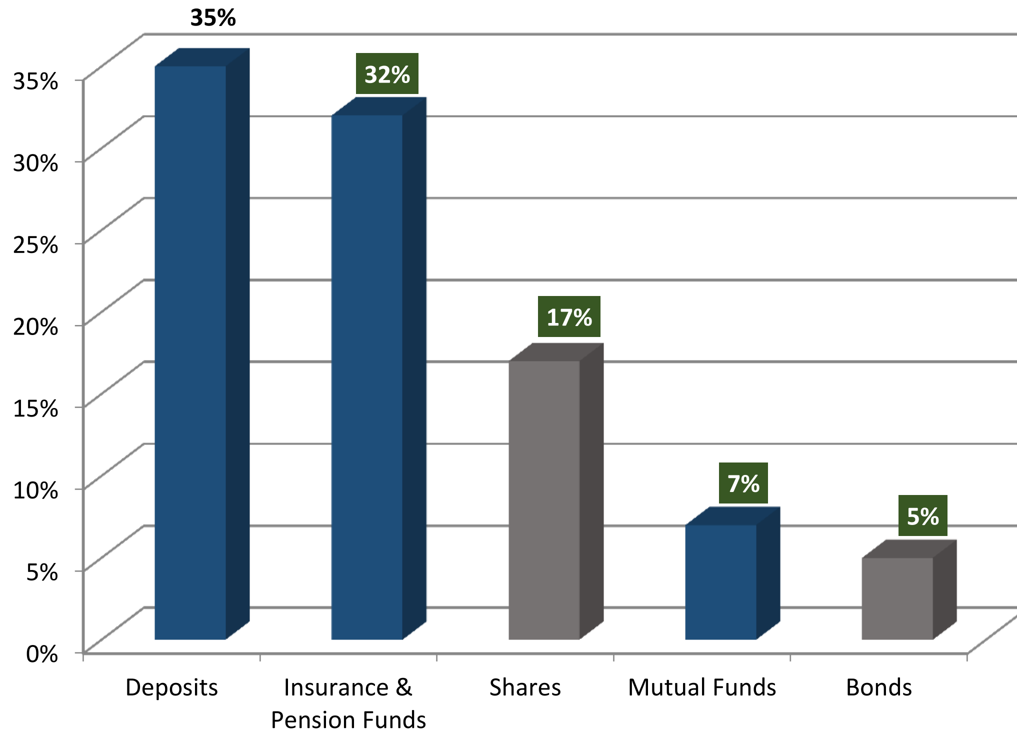
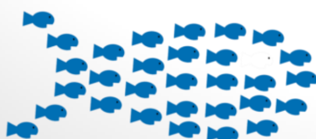


Source: ESMA[5]

As a matter of fact, EU Authorities excluded EU citizens as individual investors from the "market participants" category (under which they were represented in the CESR consultative body up to 2010) to subsequently transfer them into the "consumer" one in 2011 when the "Securities and Markets Stakeholder group" of ESMA was set up. This clearly demonstrates that EU Authorities no longer wanted to consider individual investors as capital market participants despite their ongoing active role, in particular in SME primary markets.

[5] ESMA Report on Trends, Risks and Vulnerabilities, No. 1, 2014.



Indirect investments from households into capital markets via "packaged" products today represent by far the major part of "retail" investments. There are quite a few priorities that EU Authorities should consider in the short term to restore individual savers' and investors' confidence in financial intermediaries such as asset managers, life insurers and pension funds. **However, direct investments from individual investors into capital markets are discriminated against**: while direct "retail" investment into capital markets nowadays represent only a minority share of households financial savings (about 25%, compared to about 75% in intermediated – "packaged" – investment products such as bank deposits, life insurance and pension funds), it is still significant despite most recent regulatory reforms blatantly favouring "professional" and financial "investors" (actually mostly financial intermediaries managing other people's money) over end investors such as individual ones[6].

As the European Commission states, *"other reasons for not saving long-term are the often poor performance of financial intermediaries to deliver reasonable return, and costs of intermediation"*[7].

Finally, we must also refer to the project for bank structural reform, which should partially address the over-reliance of the European economy on bank-based finance. As the table below shows, not only does 76 % of the funding of the EU economy come from banks, but they also seized a very important share of the European capital markets: half of fixed income securities and 23 % of the market capitalisation of equities to be precise. This is considerably more than in the much larger US capital markets. This massive presence of banks in the European capital markets is crowding real economy issuers further out.

[6] The most striking example is MiFID I which fragmented capital markets in Europe, creating new "market venues" which are not – at least directly and easily – accessible to individual investors, and deprive them from consolidated trade data (pre- and post-trade) since 2007.

[7] European Commission Staff Working Document for the Green Paper on the long term financing of the EU economy, 2013.

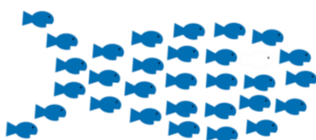


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Table 4: Bank-based versus Market-based financing in the EU and USA

	EU	USA
Share of bank funding	76%	27%
Share of capital market funding	24%	73%
Share of financial institutions in bonds	50%	40%
Share of financial institutions in equities	23%	16%

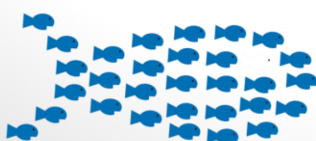
Sources: Better Finance, Deutsche Börse, ECMI

One of the reasons for this extreme reliance of the EU economy on bank funding is the "Too Big to Fail" syndrome or the importance of European "SIFIs" (Systemically Important Financial Institutions). In fact, SIFIs are by far the biggest issuers among all financial institutions in the European fixed income and equity markets. Basel III and CRD IV rules – by incentivising SIFIs to raise more equity and quasi-equity funding on capital markets - can only further favour such a crowding out of the real economy by the SIFIs from EU capital markets. This is one important reason why – among others – Better Finance recommends to go forward with a meaningful reform of banking structures in the EU and thus reduce the size of SIFIs - especially by downsizing their re-intermediation of European capital markets - in order to in turn reduce the crowding out effect on the real economy.

2) ***What further steps with view on the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?***

SME credit information should be protected from becoming a "transferable product". The owners of SME credit information should be SMEs themselves and they should be the ones to decide how to handle it.

Any aspect or outcome of SME credit information (credit scoring for example) should be available, at no cost, and in an understandable way, first to SMEs themselves and second to their representing bodies (at aggregate levels). This piece of information is crucial in understanding how obstacles to access to finance can emerge.



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3) What support can be given to ELTIFs to encourage their take up?

Any successful development of ELTIFs should consider:

- Setting a high threshold for minimum investments in ELTIFs: those should be "advised" only to qualified and financially very literate individual investors.
- Eliminating the plethora of already existing long term AIF fund categories which are nationally incentivised (nine such categories exist in France alone, all with tax incentives): see below response to Q.11.
- Granting the "most favoured nation" clause to ELTIFs for its tax treatment in Member States.
- Selling the same ELTIFs to all investors – retail or not, and ban funds of funds which add another layer of fees.
- Applying the product disclosure rules of UCITS funds.
- Making listed small cap equity an eligible asset class.
- Forbid mixing SME assets with infrastructure ones in the same fund.
- Also allow closed-end listed ELTIFs to address the liquidity issue.

4) Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree on common standards?

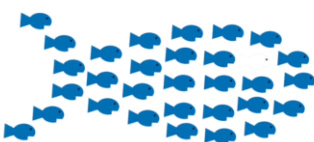
EU citizens as individual investors are mostly not involved in private placements: this EC short term priority is not addressed to them.

5) What further measures could help to increase access to funding and channelling of funds to those who need them?

Generally, the current incentives provided by the structure of the financing tools and the tax system favour debt financing. Assuming that we are looking to turn financing more towards equity, these incentives should change.

Focusing on SMEs; in principle, the smaller the size of an enterprise, the higher the risk and this will be reflected in the cost of capital. This gap cannot be covered by any privately governed initiatives, no matter if they are active in a domestic, a pan-European or a global capital market, or bank. Europe needs financing structures that would aim to deal with this gap in an efficient way, by adopting a broader set of evaluation tools when a request for a loan is evaluated.

The Green paper has also referred to information problems; small entrepreneurs tend not to be aware of financing alternatives (as the paper correctly identifies), and most of them do not have



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specific financing expertise, skills and competencies to be able to choose the best alternative among those they are offered. This results in the entrepreneur seeking advice from external parties (usually accountants, tax advisers, lawyers and other general consultants). For regulators and policy makers to recognize and support those delivering these advisory services would enhance the probability of these small entrepreneurs to seek finance.

6) ***Should measures be taken to promote greater liquidity in corporate bond markets, such as standardisation? If so, which measures are needed and can these be achieved by the market, or is regulatory action required?***

Certainly. The 2008 crisis demonstrated that fixed income markets were much more illiquid than equity ones and virtually stopped in many instances. To achieve that, access, transparency and liquidity (at least for the larger bond issues) should be improved and be set at par with those of equity markets.

7) ***Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environment, Social and Governance) investment, including green bonds, other than supporting the development of guidelines by the market?***

The problem with ESG criteria is that they are multiple and inconsistent, and the rules and governance for setting these criteria are often obscure for EU citizens.

According to a recent Morgan Stanley survey, individual investors in the US are sending signals that display clear interest in integrating sustainability into their personal investment portfolios: 71% of individual investors are interested in sustainable investing. However, there are also clear barriers to broader adoption: 54% believe choosing between sustainability and a financial gain is a trade-off[8].

According to Morgan Stanley, Sustainable Equity Mutual Funds had equal or higher median returns and equal or lower volatility than traditional funds for 64% of the periods examined[9].

Better Finance considers that to facilitate the development of standardised, transparent and accountable ESG investment, it is necessary to equip individual investors with the tools and resources needed to properly evaluate and compare sustainable investments across asset classes in terms of the financial characteristics but also the ESG characteristics.

[8] Available here.

[9] Available here.

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Indeed, there is still confusion about defining an absolute term, concept and methodology for ESG investment. In addition, ESG management processes are often too technical, complex and dubious for investors.

A variety of 'sustainability' labels have emerged that aim to provide certain quality standards. Their goal is to provide individual investors with a framework for ESG products and to offer more transparency about investment products. But this variety of private labels is also source of great confusion. Therefore, there is a need for a single European label which investors can trust to invest their assets in investment funds which incorporate ESG considerations throughout its investment process.

These resources will become critical in helping investors of all sizes make informed decisions.

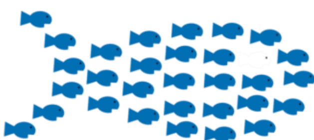
8) ***Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?***

To effectively ensure that the flows of finance in the internal market are truly extended to cross border activities it is essential for there to be standardization in financial reporting so that investors, other providers of finance and users of financial services are able to make reasonable assessments in their finance decisions.

All listed SMEs should follow the IFRS for their financial reporting to investors. If not, investors – individual ones in particular - will not be able to compare the financial situation of those SMEs to other listed enterprises. But Member States should then also accept these same IFRS for their national requirements to avoid duplicating financial reporting obligations for SMEs.

Better Finance does not agree to make a specific case for SMEs listed on "MTFs". MTFs are usually far less transparent and far less accessible to individual investors than the regulated markets. We see no reason for any discrimination or maintaining an uneven playing field against SME listings on regulated markets, the most protective ones for individual investors.

Also EU Authorities should at last allow individual investors to get involved in the EFRAG (European Financial reporting Advisory Group) Board as one of the major stakeholders and end-users of financial reporting, and as recommended by the Maystadt Report endorsed by the EC but not implemented so far by EFRAG. EFRAG thus remains one of the very few EU financial policy advisory groups to still exclude EU citizens as individual investors in their governing body.



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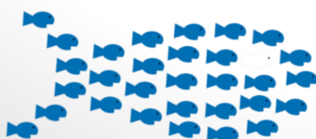
9) Are there barriers to the development of appropriately regulated crowdfunding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

The relatively new and innovative crowdfunding industry seems to be following divergent ways of development across member states. The most important consequence of this fact is the difference in the regulatory environment. Regulations on financial crowdfunding should be urgently harmonised to enable a Pan-European market to emerge and to develop EU – based platforms that could compete with the US ones. A relevant European regulatory framework for equity crowdfunding and peer to peer lending could first provide guidelines and solutions for national competent authorities and also boost cross-border flow of capital via this new financing tool.

10) What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

Today institutional investors are more risk averse and short term oriented than individual investors. In particular their already low equity exposure has dropped dramatically since the beginning of this century as the table below shows:



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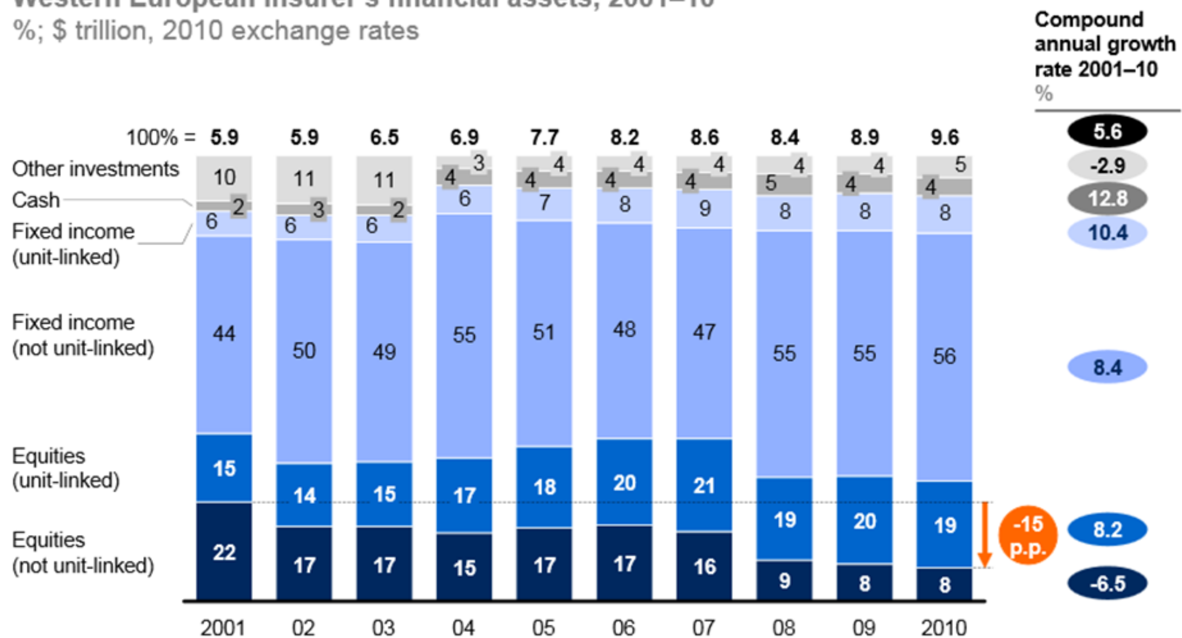


"Institutional investors" appear less long-term oriented and more risk averse than individual investors. As shown in table 2 below, Western European insurers have reduced their own equity holdings from 22% to 8% of their total investments[10] from 2001 to 2010. Real estate investments are also likely to have been reduced from what was already a low level, as "other investments" went down from 10% to 5% over the same period. And these trends started before the Solvency II Directive. It is unfortunate that one cannot find more recent data than 2010: we suspect the downward trend for investments in equities by insurers to continue further.

For pension funds - the other large European "institutional" investor category - we note that UK pension funds have reduced their overall corporate equity holdings from close to 50% to below 25% from 2000 to 2013[11], despite the long average maturity of their pension obligations. Likewise, the Bulgarian and the biggest French pension funds (RAFP, Prefon, Corem) have invested less than 20% of their assets in equities.

[10] Insurers are not the economic owners of Unit-linked investments as the investment risk is totally or mostly borne by their clients – mostly individual ones - in that case.

[11] "Pension Savings: The Real Returns", 2014 Edition, Better Finance, Table 104 "Breakdown of self-administered pension fund asset holdings", page 181.

By contrast, in DC (defined contribution) pension plans where individual participants have a choice of asset allocation and bear the investment risk ("*instividual*" DC plans, as they are called in the US) the allocation to equities is often much higher: the € 60 billion national Swedish DC pension plan PPM is invested for 80% in equities. Likewise, the participants in the French corporate DC plans (PEE and PERCO) have allocated 57 % to equities (including employee stock).

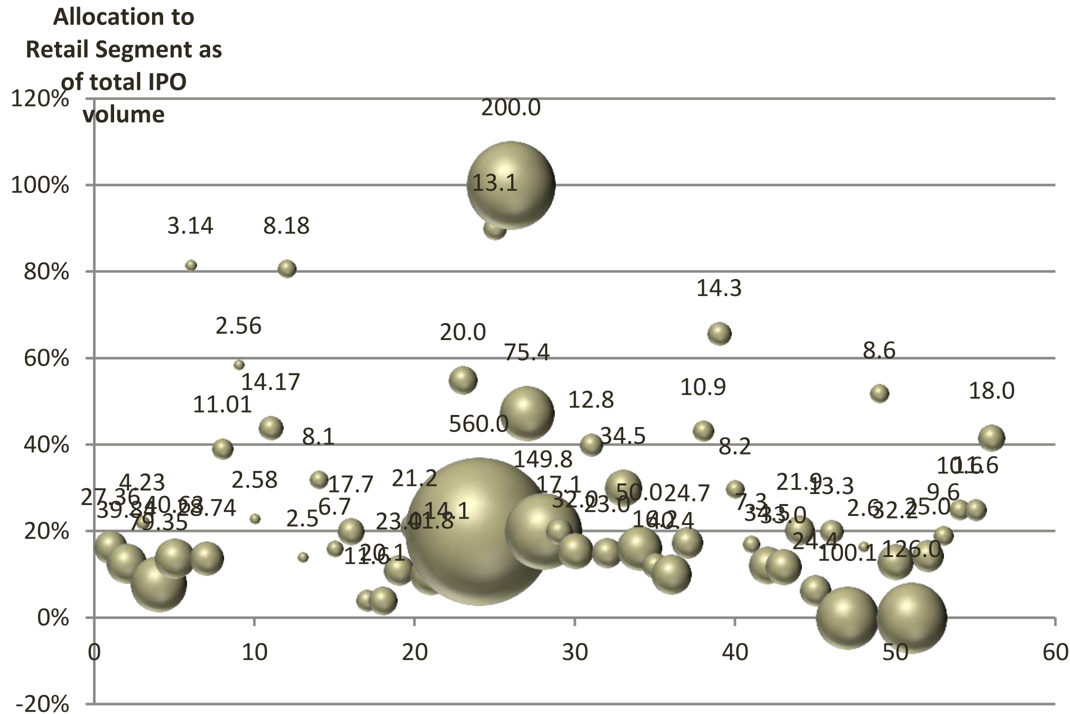
EU citizens as individual investors need positive incentives ("carrots"), and not "sticks", to channel savings into long term investments for the real economy, since they are already suffering from the "financial repression" which – together with excessively high fees from financial institutions – currently too often destroy the real value of their savings.

In particular, tax incentives for direct equity investments (e.g. share savings plans) would support further growth, especially if channelled to growth companies and connected to a long-term holding period. We point for example to the UK Finance Act 2013 and its consequences for the Alternative Investment Market (AIM) which enables individual investors to invest in AIM companies through their Individual Savings Accounts (ISAs). ISAs are tax efficient since an individual pays no tax on the income received from ISA savings and investments or capital gains up to an annual limit of GBP 15,000 (for 2015). In addition, further tax exemptions (e.g. stamp duty) apply to investments in growth companies as well. Another example is the French PEA ("*Plan d'Epargne en Actions*" or Equity Savings Plan) which exempts individual investors from income and capital gains taxes if they hold their equity (or equity funds) investments for more than eight years. We are aware that tax incentives should not be considered as the principal reason for investment. However they can enhance financial returns if the tax incentives are not "captured" by the providers in higher fees and commissions. And there should be no tax bias in favour of short term investments over equity.

Better Finance found no convincing evidence to assert that individual investors would be more risk averse than other categories of investors. Actually, we found quite the contrary:

For example, the share of individual investors in the primary (IPOs) and secondary market transactions for SMEs (small and mid-caps) is at least twice than that in the big caps markets. Inversely, the share of "institutional" ones is significantly lower for SMEs. Who is more risk averse?

The graph below provides some evidence on the higher participation on average of retail investors in small-cap IPOs according to EnterNext (alternative listing venue provided by EuroNext). The **weighted average retail allocation** in the 56 EnterNext IPOs between 2012 and 2015 was **26,15%**.



- Allow a special treatment by prudential regulation of all long term & pension products allowing for a more effective asset allocation.
- For industry and media to refer to large “all-tradable” indices instead of blue chip ones when they communicate on “equity markets”. Indeed, most often , asset managers and the like actually refer only to narrow «large cap» indices when they talk about «equity markets», thus depriving listed or to be listed mid and small enterprises from more liquidity and investments, and depriving investors from higher long term returns as broad equity indices have largely outperformed narrow ones over the long term[12].

This is why Better Finance proposes to simplify, standardize and streamline the range of product offerings by:

[12] For example, over the last ten years as of 13 March 2015, the US S&P 500 index (500 large cap stocks) has returned + 71%, while the MSCI US Investable Market 2500 index (2500 stocks) has returned +123 %, although the former captures approximately 80% of the US available market capitalization.

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- Forbidding the use of non-UCITs funds (the 20 000 or so "AIFs") in all packaged long-term and pension products promoted to individual investors.
- Reducing the excessive number of UCITs on offer in the EU
- Replacing the specific and nationally incentivised long term investment funds by the pan-European ELTIFs
- ESAs making full use of their product intervention powers in order to ban any toxic investment product targeted at individual investors.
- ESAs ensuring EU individual investors have full access to low cost index ETFs

Also, we believe that the following actions are needed:

- Lower the costs and fees on long term packaged products to provide a decent return to savers and closer to that of capital markets.
- Establish EU-wide transparent, competitive and standardised retail annuities markets; and consider more freedom to pension savers to choose between annuities and withdrawals, but after enforcing a minimum threshold for guaranteed life time retirement income.
- Improve the governance of collective schemes: at least half of the schemes' supervisory bodies should be designated directly by the pension schemes' participants
- End biased advice at the point of sale and guarantee competent advice on long term investments, including equities and bonds; more powers to supervisors to ban "retail" distribution of toxic packaged investment products

11) What steps could be taken to reduce the costs to fund managers of setting up and marketing funds across the EU? What barriers are there to funds benefiting from economies of scale?

There are 33 000 funds in the EU versus 8000 in the US. The average size of an EU fund is about €200 million versus €1600 million in the US, i.e. 8 times bigger. The annual fees of EU equity funds are 175 bps (2010: last available info) versus 74 bps in the US (2013). Better Finance also refers to the research report it published last year on *the performance and efficiency of the EU asset management industry*, which underlined its poor overall performance[13].

[13] Available here.

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	Number of funds	Average Size (euro million)	Average fee (equity funds only, bps)
EU	32.750	222	175 (2010)
US	7.886	1.568	74 (2013)

Source: Efama (2011), ICI (2014)

Banks and insurance companies prefer to market their own or their partners' expensive actively managed funds, but that there are very few if any "retail" intermediaries marketing passive funds. Direct access to such funds via the stock market is too difficult for small savers without advice, which means consumers are forced to acquire actively managed funds or "retail" index funds priced like active funds.

The number of funds must be drastically reduced, especially AIFs as they are more numerous (about 20,000), smaller, less transparent for individual investors, and most often only distributed on a national basis. For example, Better Finance is proposing to ban AIFs in retail packaged products such as unit-linked insurance contracts and pension plans, in favour of UCITS.

For individual EU investors the problem is compounded by the fact that direct fund holdings account for only 7 % of their financial assets: most economic retail ownership of funds is through wrappers that add yet another layer of costs further reducing the net returns to EU citizens.

As already proposed in Q 10:

- Forbid the use of non-UCITs funds (the 20,000 or so "AIFs") in all packaged long-term and pension products promoted to individual investors.
- Reduce the excessive number of UCITs on offer in the EU
- Replace the specific and nationally sponsored long term investment funds by the pan-European ELTIFs

12) Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets? If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?

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13) Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

The only true current Pan-European investment product is UCITS funds (see above). But this is not a product adapted for retirement savings as such.

Better Finance would strongly support a Pan-European simple retirement savings vehicle to protect long-term purchasing power of savings, that is:

- readily accessible, without need for advice (and no related fees), meaning it is clear and intelligible for most individuals, like the IRA (Individual Retirement Account) in the US
- supervised by public bodies
- largely opened to all substitutable investment vehicles like the IRA (Individual Retirement Account) in the US
- transferable to any other retirement savings product either individual or collective/occupational, like the IRA (Individual Retirement Account) in the US
- with a simple and clear default option guaranteeing at least the long term protection of the purchasing power of the pension savings.- A contract with transparent contract clauses related to early withdrawal, exemption from payment of premiums; participation of benefits; and with several pay-out options (annuities or lump sum).

14) Would changes to the EuVECA and EuSEF Regulations make it easier for larger EU fund managers to run these types of funds? What other changes if any should be made to increase the number of these types of fund?

These products are not aimed at individual investors.

15) How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

Reporting of private equity funds performances and consolidated fees should be thoroughly improved and reviewed by the supervisors. Up to now, evidence provided by the EC (Staff working document accompanying the green paper on the long term financing of the EU economy) on the supposedly superior long term return of private equity versus listed equity remains quite unconvincing.

16) Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

Regarding non-bank direct lending, the innovative alternative of p2p lending comprises a promising complementary to the banks financial infrastructure that will help SMEs and especially micro and small enterprises to get access to financing. A relevant European regulatory framework for peer to peer lending (and equity crowdfunding) is needed, as a necessary prerequisite for cross-border flows of capital.

17) How can cross border retail participation in UCITS be increased?

Simplify, standardize and streamline the range of product offerings

UCITs are much more cross-border than AIFs (Alternative Investment Funds) already because the two major domiciles for UCITs are largely "off-shore": Luxembourg and Ireland (i.e. most of Luxembourg- and Irish-domiciled funds are distributed in other EU countries) whereas the vast majority of AIFs are purely sold on a national basis. Contrary to a common belief, AIFs are massively sold to EU households who own much more AIF funds than UCITs ones. One very powerful way to increase cross-border distribution of funds in the EU – especially for «retail» - is therefore to drastically reduce the number of retail AIFs

- Forbid the use of non-UCITs funds (the 20 000 or so "AIFs") in all packaged long-term and pension products promoted to individual investors.
- Reduce the excessive number of UCITs on offer in the EU
- Replace the specific and nationally sponsored long term investment funds by the pan-European ELTIFs

The ESAs and the National Competent Authorities should also make use of their product intervention powers to ban any toxic retail investment product, including those for which the probability to meet their stated investment objective is non-existent or very low. For example, this would be the case of «closet index funds « (falsely active funds) and of retail «index» funds (i.e. with a promise to closely track the index) which charge 1 to 2% annually (making it de facto impossible to closely track the index), when the same index funds but in an ETF[14] version charge 5 to 10 times less per annum.

18) How can the ESAs further contribute to ensuring consumer and investor protection?

ESAs should first make full use of their legal duties and powers in terms of data collection, analysis, and publication, in particular in the areas of returns and prices (fees) (article 9.1 of the ESAs Regulations) and of product intervention (article 9.5) to ban toxic products that bring negative value to investors.

[14] Exchange Traded Funds.

They should also better enforce existing investor protection rules.

a. Product intervention: see last paragraph of reply to 17 above.
b. The European Supervisory Authorities (ESAs) must better comply with their legal duty to analyse and report on long term and pension investor trends, including actual net performance and fees of all retail long term and pension products (article 9.1 of the ESAS Regulations).
c. Single rulebook, supervisory convergence and governance of the ESAs should be improved in line with the Better Finance's requests laid out in its reply to the consultation on the review of the ESFS.
d. Similarly, the EU should entrust ESMA with full competency and powers on all savers and investors' protection issues, and stop fragmenting investor protection between three different ESAs.
e. Next to its involvement in the operation of the proxy advisory industry, ESMA should additionally be entrusted with improving the proxy voting process for shareholders, e.g., by ensuring for standardized workflows within the intermediaries chain and by developing harmonized EU-wide accepted proxy forms.

For all these key tasks to be effectively performed, the resources of the ESAs created in 2010 should be reinforced, not reduced as decided by the European Authorities.

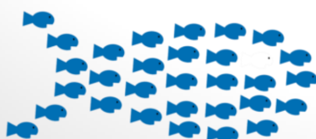
19) What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

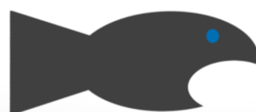
It is important to boost trust in capital markets. Investor protection is a key driver of EU financial legislation and will be needed to revive confidence in financial markets. Only when investors feel adequately protected will they be willing to channel their money into capital markets.

Two recent independent research reports have tried to fill the gap left by supervisors and public authorities to assess the past performance of "retail" investment products. They both struggled to collect all relevant data. For example, researchers could not find any published consolidated data on average actual entry fees charged to individual investors. They had to estimate those. Both studies validate and confirm the European Commission's staff document quoted above.

The most comprehensive is – since 2013 - the annual report on the real return of long term and pension savings produced by Better Finance, produced with the help of independent experts and academics[15]. It now covers 75 % of the EU population, and a vast range of long term packaged

[15] Pension Savings: The Real Returns, 2014 Edition, Better Finance, available here.





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products (occupational pension funds, life insurance, personal pension plans, etc.). It shows how different, and much lower, the returns of packaged products can be from those of the underlying capital markets. A lot of these products have failed to protect the real value of EU savings (net of inflation) since the beginning of this century, as the example below shows.

Example: Long-term returns of a Belgian "group pension insurance" product

Capital markets vs. Belgian occupational pension fund 13 year perforance (2000 to 2012)	
Capital markets (benchmark index*) performance	
Nominal performance	+48%
Real performance (before tax)	+11%
Fund performance	
Nominal performance	+8%
Real performance (before tax)	-19%

*50% equity / 50% bonds (MSCI World Equity index and JPM Euro Bond Index)

The other research was sponsored by the European Commission's FSUG (Financial Services User Group) in 2014 and focused on investment funds[16]. It shows that a majority of investment funds domiciled in the EU have failed to match the performances of their capital market benchmarks over the last ten years. In addition, this research could not distinguish funds that are promoted and sold to individuals from those which are offered to bigger "institutional" investors only. If the study had been capable of isolating the past performances of the former alone, the results would have probably been even worse on average.

Both reports point out to the costs and fees as the major explanation for the disappointing average performances.

In addition it is necessary to strengthen the ability of (especially) individual investors to engage with the companies they are invested in. An important means, especially for individual investors in that respect is the exercise of their voting rights stemming from their shares. As recent research by Better Finance shows, however, there still is no real single market for shareholder rights within the EU (see "Barriers to Shareholder Engagement, Better Finance report 2012).

[16] Study on the Performance and Efficiency of the Asset Management, commissioned by the Financial Services Users Group (FSUG) of the European Commission to Insead OEE Data Services, August 2014. Available here.

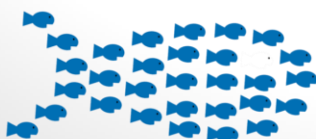
While voting within one Member State today seems to work without inadequate burdens or costs for shareholders, the voting process across borders still remains difficult and is very often too costly. Although these issues have been tackled by the SRD, the provisions will not suffice to solve the problems described in Better Finance's report. This is mainly due to an inefficient custody chain complemented by a lack of knowledge at the deposit banks' "point of sale". First steps could be the introduction of a common EU voting form and the introduction of a uniform record date for the entitlement to attend/vote at a general meeting. Repealing barriers to cross-border shareholder engagement as well as introducing common minimum corporate governance standards across Member States is therefore urgently needed.

In addition, Better Finance is supportive of the development of a collective redress mechanism, modelled on best practices in Member States, e.g. the Dutch collective settlement procedure/collective action.

Furthermore, we consider that improvements in the quality and quantity of financial education by advocating / fostering respective initiatives are needed. Such initiatives should not only focus on enhancing education of investors but also of financial institutions' staff members, especially in small and medium sized intermediaries/financial institutions.

The savings rate of household is already quite high in Europe. Also, contrary to what one often reads, individual investors are not shorter term or more risk averse than other investors:

- 62 % of their financial assets are invested in long term products (shares, bonds, life insurance, pension funds, mutual funds), and about 80 % of their total savings are long term if property is taken into account.
- DC plans with individual asset allocation choice tend to be more invested in equities than other DC plans (Swedish, French and US evidence at least)
- By contrast, Western European Insurers have lowered their own risk equity investments from 22 to 8 % from 2001 to 2010: way before Solvency II.
- The average holding period of shares has been going down parallel to the decrease of direct individual ownership and the increase of mutual fund ownership.
- The involvement of individual investors in SME markets is about twice as large as it is in blue chips
- What individual investors do not like it high risk – low return offerings as illustrated in the number one savings product in France: life insurance where they have largely favoured the capital guaranteed category over the unit-linked (more exposed to equities) one. They have been quite right to do so: the fists category returned a net real after tax return of 20 % since 2000, the latter a negative one of minus 14 % over the same period.



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Therefore, EU Authorities should eventually focus on **the returns and prices** (overall fees) of "retail" investment products, which are neither clearly disclosed nor decent overall, as demonstrated by recent independent research by Better Finance (on long term and pension savings products) and on investment funds.

The EU Authorities should further improve and harmonize disclosures for all **long term and retirement savings products**:

- PRIIPs[17], KID principles extended to all retail long-term and pension investment products, including shares and bonds (for which it could favourably replace the current ineffective "summary prospectus") and pension savings products. These principles should also be extended to long-term bank savings products; as the level of information on interest rates, right of withdrawal and disbursement options are sometimes very opaque.
- Standardized disclosure of past performance compared to objective market benchmarks18: long term historical returns after inflation; after all charges to the investor; and after tax. This means in particular that it is most necessary and urgent to re-introduce mandatory disclosure of the past performance of all "retail investment products and that of their benchmark(s), a disclosure requirement that has most unfortunately been scrapped by the PRIIPs Regulation, including for UCITs, which were benefiting from this mandatory disclosure in the KID thanks to the UCITS IV Directive.
- Disclosure of total costs and commissions, both direct and indirect
- Disclosure of funding status
- Disclosure of transfer/exit possibilities

They should also end biased advice at the point of sale and guarantee competent advice on long term investments, including equities and bonds; more powers to supervisors to ban "retail" distribution of toxic packaged investment products.

Finally, basic **financial mathematics and capital markets (shares and bonds) basics** to be part of school curricula; financial institutions to have at least a part of the use of their financial education resources supervised by independent foundations. Adults should also be educated on consumer/investor rights and on how to assert them and on how/where to find independent information and advice.

[17] Packaged Retail and Insurance-based Investment Products – EC Regulation.

[18] This requirement which is now in place for all UCITs funds in the EU (a benefit of the UCITS IV Directive) has very unfortunately been eliminated in the recent PRIIPs Regulation ; it must be reinstated, otherwise individual investors will not even know if the products has lost money or not.

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20) Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

Better Finance wants to see more effective cross border competition. We have observed too many examples of risky practices and poor value products and services transferred cross-border within the EU, rather than good practices which should be expected if the market was working for financial users. Far too many EU citizens are being denied the best the market can offer due to the barriers which prevent them from buying financial services in countries in which they are not resident.

With regards to retail financial services, there is still much to be done to create a well-functioning single market for consumers. But it is very important to distinguish between the illusion of competitive activity and competition that works in the interests of financial users.

This effective single market will not be delivered by liberalising the market or removing perceived barriers to entry. This risks promoting regulatory arbitrage and a move to lowest common denominator consumer protection. This will undermine consumer confidence and severely curtail the development of a real single market that works for financial users.

We note with some concern the statement on page 17 of the Green Paper:

The regulatory cost of setting up funds, becoming authorised managers and selling them across borders, currently varies between Member States. Reducing costs for setting up funds, and cross border marketing more generally, would lower barriers to entry and create more competition.

Of course, we agree that it is important that we have a consistent framework for regulating the setting up and management of investment funds. But the tone of this statement seems to suggest a very conventional, outmoded approach to competition that the problem with the asset management industry is a lack of choice and that regulation is some sort of burden. Let's be clear. With more than 33,000 funds (versus 8000 in the US for a market more than twice as big) the problem in the asset management is not lack of choice *per se*. The problem is a proliferation of socially useless products, poor value, embedded inefficiencies and lack of trust and confidence.

The focus should be on improving the quality of choices available not encouraging more choice *per se.* To do this we need tough, targeted regulatory interventions focusing on:

- reducing costs;
- streamlining the investment industry;
- encouraging economies of scale;
- preventing misleading marketing and promotions;

- product regulation to minimise the risk of toxic investment financial products being manufactured and distributed through the supply chain and promote the development of standardised, easily compared, good value products;
- promoting effective competition that works in the interests of financial users by tacking the conflicts of interest that exist in the supply chain between product manufacturers, intermediaries (advisers, salespeople and information providers) and financial users;
- ensuring that the various agents in the supply chain properly exercise fiduciary duties of care and take seriously their stewardship duties; and
- driving out short-termism and promoting long term patient investment.

Relying on transparency and disclosure and reducing barriers to entry to encourage even more choice will not be effective.

This approach would also support the development of ESG and greater investor engagement. One of the excuses used by the asset management industry for not promoting ESG and engaging with investors is that this involves higher costs. However, if the asset management industry was forced to become more efficient this would of course free up resources to allow for greater investor engagement and greater use of ESG.

"Livret A" in France is an example of good national practice for very short term savings: a simple, understandable, tax free interest bearing on sight bank savings account for which the interest is pegged to inflation by law. But it does not address long term saving needs. Worse, it is often misused as a long term savings tool.

21) Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

Yes. We would like to first of all refer to the following citation which in our opinion shows many of the problems that citizens experience when dealing with financial markets: "*Equity markets demonstrated a perverse sense of fairness, blatantly favouring the technologically empowered over the retail investor*"[19].

The previous statement can be complemented with the following graph showing the differences in the performance of financial markets and the final benefit delivered to the retail investor:

[19] Mark Carney, Governor of the Bank of England (Conference on Inclusive Capitalism, London 27 May 2014).

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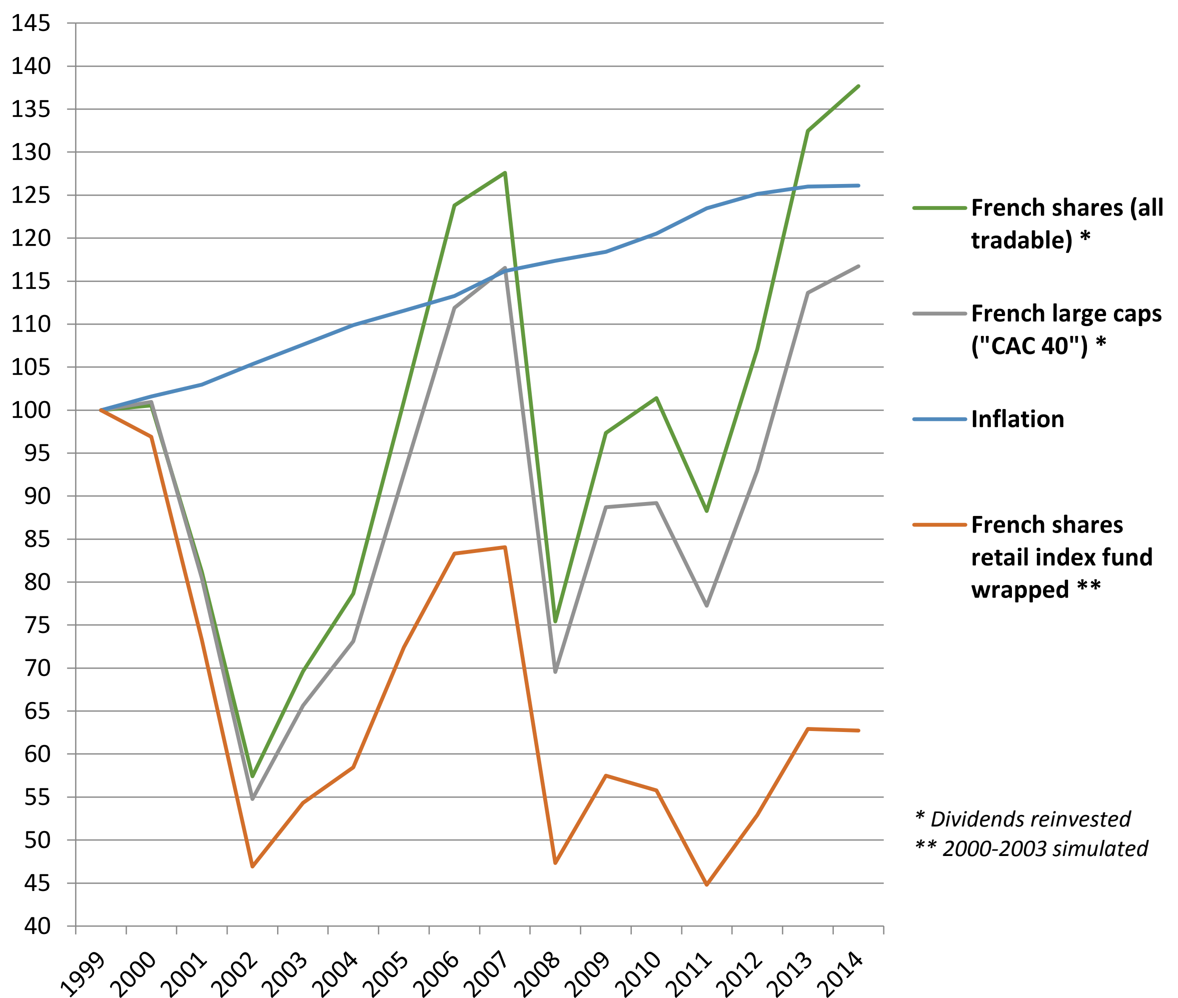
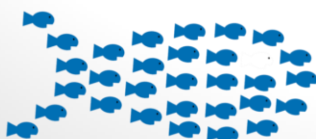
This lost opportunity for investors is not only the consequence of higher long term performance, but also comes from the lack of communication, promotion, marketing and "education" of individual investors on the benefits of total equity market investing and of SME market investing. Individual investors learn almost only of narrow large cap indices and not of "all tradable" ones, and are mostly offered investment choices (funds, ETFs, etc.) based on the former solely. Likewise, EU SMEs suffer from this misnomer, as it excludes them de facto from the "equity





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markets" as publicly advertised and marketed.

In the case of France, the total listed equity market is the only one to have beaten inflation since 2000, not the "blue chip" and narrow ("CAC40": only 40 companies) one.

Similar conclusions can be drawn for other developed equity markets. For example, over the last ten years, the US S&P 500 index (500 large cap stocks) has returned + 71%, while the MSCI US Investable Market 2500 index (2500 stocks) has returned +123 %[20], although the former captures approximately 80% of the US available market capitalization.

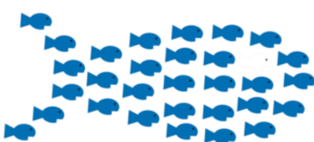
The tools do exist and could be further developed for the EU "total" equity markets: these broad, "all tradable" indices already exist and investment products could be much more developed, the way they have been in the US[21]. Ending this cultural bias would therefore eventually channel much more investor interest and flows to listed - or to be listed - SMEs. This measure would not require any new regulation to be put in place.

The first of the two tables below is based on recent research produced at the request of the European Commission's FSUG (Financial Services User Group)[22]. It illustrates the fact that the decline in the direct ownership of EU domiciled listed businesses is correlated to the rise of the ownership by investment funds from about 5% forty years ago to 25% today. Indeed, from the 1970s on, "retail" financial intermediaries gradually stopped communicating and promoting shares (and bonds) to individual investors, and stopped educating them about equities, bonds and capital markets, switching to the advertising, promotion and communication of "packaged" investment products, especially investment funds, but also more complex ones such as unit-linked insurance contracts. The following table shows that a similar - although less dramatic – evolution occurred in the US over the last decades:

[20] As of 13 March 2015.

[21] For example, assets gathered in the US total stock market index fund from the Vanguard Group alone (one of the major index and ETF players) amount to US$ 406 billion, and US$ 44 billion in the Vanguard extended market index fund comprising only small and mid-cap stocks, including a lot of individual investors' money. Indexing broader indices is of course more difficult than replicating narrow indices of very liquid shares, but such techniques as sampling smaller and less liquid shares can generate very good results in terms of tracking error.

22 "Who owns the real economy? Evolution of the ownership of EU-listed companies between 1970 and 2012." INSEAD – OEE, August 2013. Available here.



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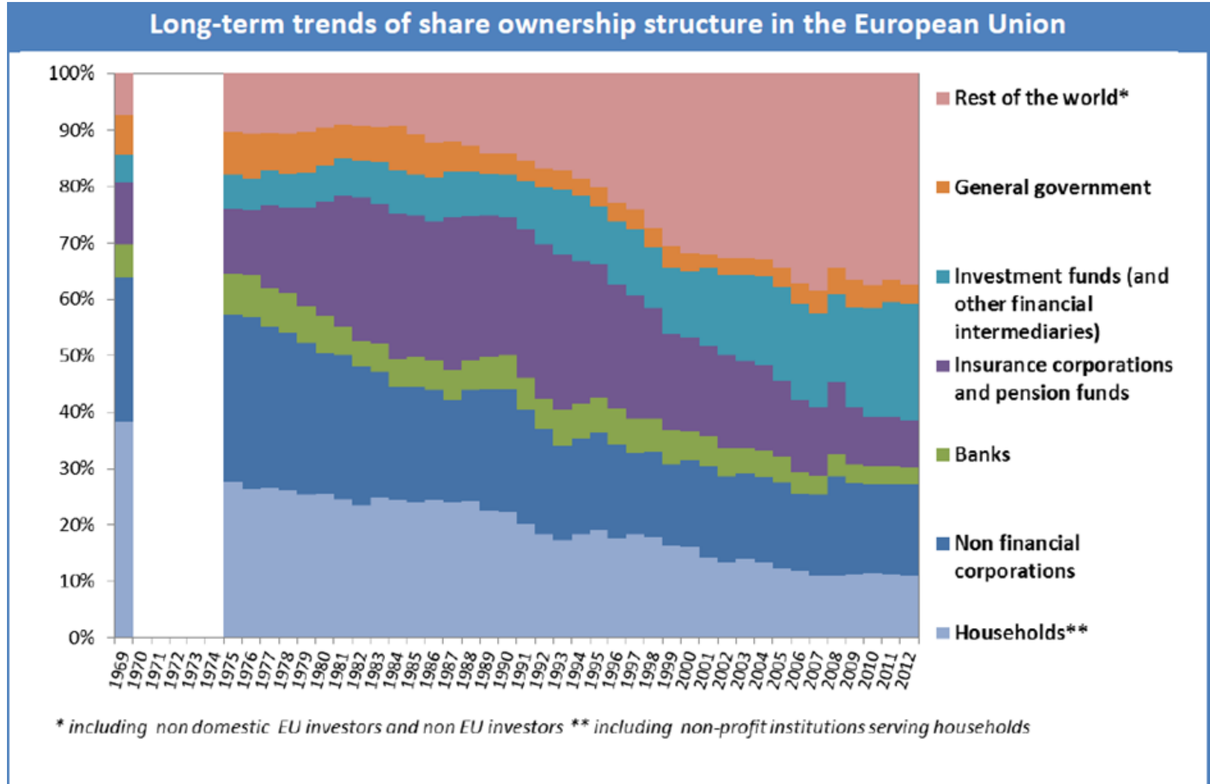

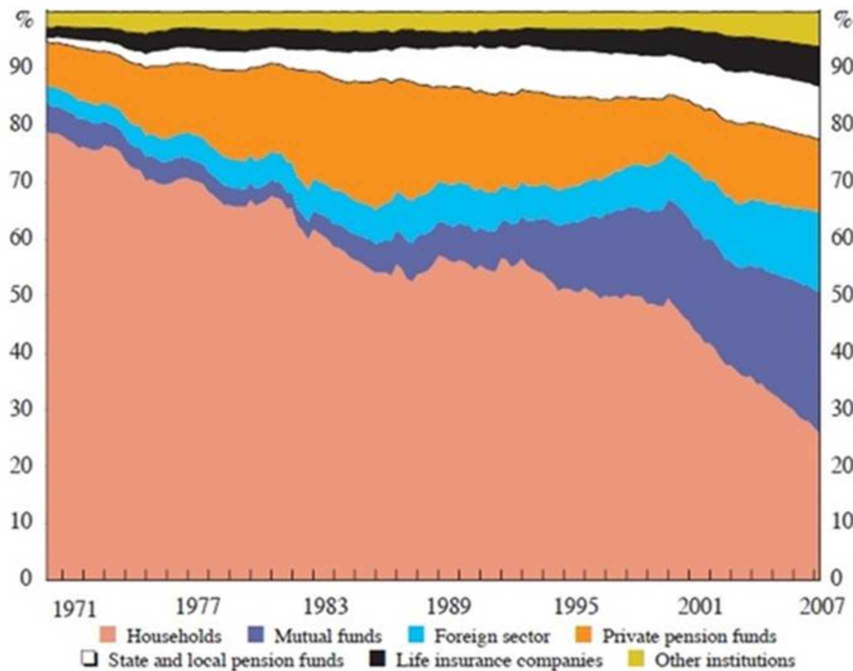

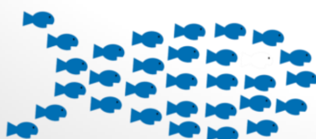

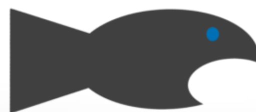

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The key driver for the switch by EU individual investors from direct equity and bond ownership to indirect ownership via "packaged" investment products is the relative profitability of these two investment product categories <u>for the financial industry and distributors</u>: "packaged" products such as investment funds and life insurance. The latter generate much more commission and fees than the former: "retail" entry fees for packaged products are typically much higher than brokerage fees for shares and bonds. More importantly, the direct ownership of shares and bonds does not generate any of the annual asset-based fees that provide the bulk of revenues for the providers and distributors. Of course, packaged products can provide benefits for individual investors such as diversification and access to professional asset management, but as already mentioned, such products are most often "sold rather than bought". Therefore, these features are most probably not the main explanatory factor for the switch.

The providers' profitability factor also explains why plain vanilla index ETFs[23] – which are low cost and simple listed investment products allowing investors to own diversified portfolios of a given market or market segment – are for 90 % bought by institutional investors in Europe (versus only 50 % in the US). They are altogether not communicated about, explained or promoted by "retail" financial intermediaries in Europe, depriving individual investors of an easy, simple and often performing opportunity to invest into capital markets.

There are other reasons for individual investors having shied away from capital markets in recent decades; such as the extreme market fragmentation is detrimental to individual investors and to real economy issuers: The MiFID I Directive, which was implemented in 2007, triggered the fragmentation of the EU securities markets. Nowadays "regulated markets" (the former Stock Exchanges) capture only about 40 % of listed equity transactions, the larger part being executed by "MTFs" (Multilateral Trading Facilities), "SIs" (Systematic Internalisers) and "OTC" (over the counter) venues (including "dark pools"). At the same time, trade data ("pre trade" ones: best offers and best bids; and "post trade" ones: latest executed trades) became fragmented too. Compared to the larger US equity market (see table 7 below), not only is the number of "market venues" in Europe five times higher, but, until this day, trade data from venues outside of regulated markets remain inaccessible to individual investors and to issuers except at an extremely high price or not at all. The provision of easily accessible, free and comprehensive delayed pre- and post-trade data for individual (non-professional) equity investors was available in the pre-MiFID era, since before MiFID, the vast majority of trades were executed in regulated markets. MiFID II was also the cause of pre and post-trade data fragmentation. Some new venues trading significant volumes no longer even show pre-trade data at all (e.g. dark pools). As regards fixed income instruments – an OTC dominated space – hardly any data at all is available

[23] ETF: Exchange traded funds.

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to retail investors, unless they are traded on a regulated market. What's more is that MiFID II will not provide for sufficient fixed income data in a timely fashion either. Most of the fixed income data available to the public will be substantially older than 15 minutes. This situation is particularly unfavourable to retail investors: they have no direct access to data from most market "venues" other than those of regulated markets, which remain virtually the only easily accessible and transparent markets. SIs, OTC and even some MTFs are not transparent for retail customers at all. The provision of trade data for all securities (shares and bonds), and for all trade venues – not only regulated markets - is mandatory in the US and falls under the supervision of the SEC, the US securities regulator.

EU equity markets fragmentation

	EU	USA
Equity markets transactions (USD trillion per annum) [24]	14	44
Number of equity markets	66	13

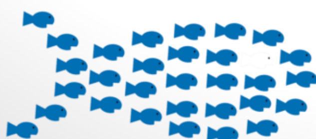
Sources: WFE, ESMA and the SEC

EU capital markets are opaque and complex for EU retail investors due to fragmentation. However, fragmentation in the EU is different from fragmentation in the US, and in fact more intense. While the US markets also have multiple competing trading venues, they do not have to cope with different legal and tax rules across fragmented markets at the same time. Neither is language a barrier to the extent it is experienced in the EU. Significant fragmentation of markets and the persistent lack of comprehensive trade data across the EU for non-professional investors are holding back capital market investments in Europe in general, as pointed out by a recent survey conducted by AFME and the BCG 25.

This situation is particularly unfavourable to individual investors: they have no direct access to most market "venues" other than the regulated markets, which can be said to be the only remaining easily accessible and transparent markets to individual investors. MTFs, SIs and OTC are mostly unknown to them. Capital markets have been made much more complex and opaque for them. Also, investor protection and transparency rules have been considerably weakened for

[24] WFE, 2014 Annual Statistics Market Highlights: figures respectively for Europe-Middle East- Africa and Americas.

[25] *"65% of the investors surveyed, who represent around €9tn of assets under management, identified market fragmentation, i.e. lack of information and understanding of differences across markets, as a factor which is holding back investments*." ('Bridging the growth gap: investor views on European)



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SI and OTC even when those "venues" are marketing their services to individual investors.

In addition, brokerage fees for individual investors have not been reduced significantly, and remain much higher than in the US. For example, the European Commission reported[26] that "US online brokers are cheaper than their EU counterparts for domestic trades and in most cases also cheaper for cross-border trades" in pre-MiFID I times. According to data from OXERA; commission rates charged by retail brokers to retail investors in major financial centres were still 19bp in 2009 and 30bp in other financial centres in 2009[27]. Better Finance member associations have not experienced any significant reduction of brokerage fees for retail investors in the EU versus the lower US ones.

In view of all this, we would like to propose the following policy actions:

a. Restore investor confidence and trust in capital markets: much stronger emphasis on EU market abuse and MiFID (best execution, conduct of business rules, misleading information, etc.) rules enforcement.
   This means improving further supervisory effectiveness and convergence, setting up collective redress mechanisms for all EU savers and private investors (private enforcement), improving tracking and sanctioning of market abuses.

b. Rehabilitate equity investing (in particular for SMEs) – as the simplest, most effective and most liquid long term direct investment product - and individual share ownership (including employee share ownership), by ensuring a level-playing field for simple securities at the retail point of sale.

c. For politicians, policy makers, industry and media to refer to "all-tradable" indices instead of blue chip ones when they communicate on "equity markets".

d. Eliminate barriers to individual shareholder engagement; in particular ensure free cross-border voting for individual investors, actual voting rights for shareholders in nominee/omnibus accounts, full rights of association for individual shareholders of any EU domiciled listed company.

e. Improve the summary prospectus for shares and bonds by making it as user-friendly, formatted, standardised, short and comparable as the KID for funds and the future KID

[26] Cost of Execution of retail equity trades in Europe in 2005
http://ec.europa.eu/internal_market/financial-markets/docs/clearing/draft/annex_3_en.pdf

[27] *"Monitoring prices, costs and volumes of trading and post-trading services"*. Report prepared for the European Commission, DG Internal Market and Services. OXERA, May 2011. Available here.

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for PRIIPs and possible "PBS" for pension fund participants (IORP review proposal from the EC) and KID for personal pension products (current EIOPA work for the EC).

f. Reduce market fragmentation, "dark" and OTC trading; impose same transparency requirements to the new marker venues (example: SIs – typically big banks - selling equity warrants without the best execution rules applying to RMs to unaware individual investors), or ban any promotion to individuals for those venues.

g. Easily accessible and free "consolidated tape" (consolidated pre – and post- trade data) for individual (non-professional) equity investors within a reasonable time lag (3 minutes max), like they had before the MiFID I induced market fragmentation.

h. Ensure easy and free access of retail investors to all major capital markets: market transparency is correlated to retail access (see 2007/2008 fixed income markets crisis): improve fixed income markets transparency and retail access; much improved retail access to bond trade data.

i. Any resumption of **securitisation** must be highly standardized and kept as simple as possible; banks should keep significant "skin in the game".

j. Align securities lending disclosure and profit sharing rules for share ownership to those applicable to UCITS funds ownership. Re-lending of lent securities should be banned, as well as the re-pledging of securities as collateral, following the Canadian example.

22) In your view, are there areas where the single rulebook remains insufficiently developed?

Yes.

In particular, in life insurance and in pension products: the IMD (insurance Mediation Directive) as it stands is still not aligned with the more protective and precise conduct of business rules of MiFID that apply to securities and investment funds. The IORP Directive as it stands is also very weak compared to MiFID on disclosure requirements to pension savers and on conduct of business rules.

Individual investors who would like to invest directly into capital markets, have been thoroughly discriminated against when compared to professional ones since the market fragmentation generated by MiFID one and the de facto annihilation of any accessible and free consolidated trade data for individual investors since then. **"Equity markets demonstrated a perverse sense of fairness, blatantly favouring the technologically empowered over the retail investor"[28].**

[28] Mark Carney, Governor of the Bank of England (Conference on Inclusive Capitalism, London 27 May 2014).

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23) Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a capital markets union?

A single EU capital market – like the banking union - will obviously not happen without a single rulebook and single supervision. See our reply to question 18 and Better Finance's reply to the Review of the ESFS.

24) Taking into account past experience, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets within the EU?

Yes. In particular, omnibus and «nominee» accounts should be strictly regulated to ensure that:

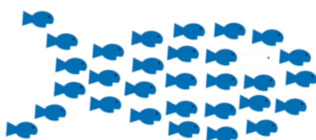
- no shareholder or bondholder has its securities lodged in such omnibus accounts without is prior and explicit consent,
- any use (collateral, lending) of his securities also requires his prior consent and clear information about who will benefit and how much from the transactions' profits
- The intermediary responsible for the omnibus account must provide timely voting material to ensure that shareholders holding their shares in nominee accounts can truly exercise their voting rights, since they are the economic owners, not the intermediary.

27) What measures could be taken to improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?

At this regard, we believe that securities' lending disclosure and profit sharing rules for share ownership should be aligned to those applicable to UCITS funds' ownership. In addition to this, the re-lending of securities already lent should be banned, as well as the re-pledging of securities as collateral, following the Canadian example.

28) What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?

Yes. Company law and corporate governance rules should be further harmonised to ensure that cross-border shareholders can really and effectively exercise their voting rights and their rights of submitting resolutions to general meetings.



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29) What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

The European Commission states that obstacles to cross-border capital flows include issues such as insolvency legislation. Barriers to the development of a truly European market include differences in national insolvency laws, lack of standardised processes, documentation and information on the creditworthiness of issuers.

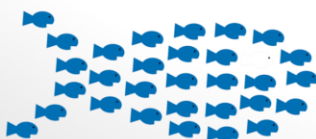
In the EU the harmonization or else of insolvency law has been discussed for many years. A major issue is that the area of insolvency law is very broad and usually the discussion is around business/corporate insolvency. However, Better Finance is concerned with consumers and SMEs. National insolvency regimes are still divergent in their basic features and in the way they operate. With the increase of consumer over-indebtedness, in the last few years many Member States have moved towards national regimes for the protection of consumers in financial distress and the treatment of the insolvency of natural persons.

The European Commission states that the diversity and in some cases inadequacy of insolvency laws across Member States has made cross-border operations and investments by companies more difficult and costly. Rules on conflict of legal jurisdictions in the area of insolvency laws across the EU make it difficult for foreign investors to assess risk. The Commission sets out proposals to modernize insolvency laws, introducing minimum standards, with a view to benefiting creditors.

But a reformed common system for the treatment of the insolvency of natural persons at EU level, which departs from the current approach of mutual recognition, may be beneficial to provide a more complete response to address the needs of European consumers, not only to protect them against over-indebtedness and counterproductive and destructive debt management and enforcement practices that are also detrimental for creditors,[29] but also in terms of wider access to capital and a more competitive market. Reducing divergences could contribute to the emergence of a European or cross-border capital market also for consumers, by reducing uncertainty for investors needing to assess the risks in several Member States. National differences in insolvency proceedings can lead to low recovery rates or costly procedures for creditors and discourage investors. Thus, to the extent that the supply side finds an environment favourable for debt solutions it may be encouraged to open up capital access for consumers and SMEs.

In short, the lack of harmonization of insolvency law is a barrier to an effective Capital Markets Union also for consumers and SMEs.

[29] See FSUG's Position Paper on the "Study on means to protect consumers in financial difficulty: personal bankruptcy, *datio in solutum* of mortgages, and restrictions on debt collection abusive practices" (March 2013).



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It would take too much time and efforts to harmonize corporate and insolvency laws in the 28 Member States. The best would be the UCITS approach: to create a European corpus of insolvency law by default and investors will most likely progressively push companies to adopt this Pan –European insolvency law framework rather than their national one.

30) What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

There is no single capital market as there are still numerous cases of double taxation of cross-border dividends (for example between Belgium and France) or of administrative nightmare to recover the originating country's withholding tax (Italy, France for example).

From the investors' point of view it is of high importance that finally the distortions created by the current system of taxing cross-border dividends[30] are addressed and solved in order to eliminate the factual double taxation of cross-border dividends and interests at investor level within the EU and to end tax discriminations against EU investors domiciled in another Member State than the issuer or the investment provider.

Taxation issues are especially problematic in member states where consumers need to shop cross-border in order to acquire low cost investment instruments, for example ETF/index fund savings plans.

Also, there are still numerous tax discriminations against EU investors not residing in the issuer's or provider's country. The situation is even worse for pension products.

Taxation to incentivize long-term retirement savings and investment over consumption and short term savings; ELTIFs will not emerge significantly unless they get most favourable tax treatment already granted to numerous other nationally sponsored long term investment products; the FTT (financial transactions tax) should be reviewed in order to actually meet its stated goal: tax the transactions of financial institutions (the largest ones by far being the Forex ones, and then derivatives) instead of those from the real economy (end-investors, in equities – SME equities in particular - and bonds).

25) How can the EU best support the development by the market of new technologies and business models, to the benefit of integrated and efficient capital markets?

26) Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

[30] With regard to identified distortions we refer to a respective study carried out by Copenhagen Economics already in 2012 on behalf of the EU Commission, more information here.

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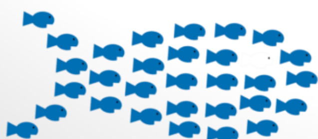
As mentioned at the beginning, the Green Paper devotes only one page to individual investors although it recognises at the same time (Staff Working Document) that they account for 60% of financial sources for the real economy. A CMU will not be achieved by addressing only issues for professionals: any successful CMU initiative must involve and attract individual investors. Those have lost confidence in investment products as the EU scoreboard repeatedly demonstrates. Therefore, any CMU initiative will have to focus much more on:

- restoring individual investors trust by much more thoroughly combat market abuses, misleading information and biased advice
- This must be done by some regulation adjustments (restoring disclosure of past performance of the product and its benchmark in the PRIIPs Regulation, and aligning IMD and IORP conduct of business rules to those of MifID for example),
- but mostly by a much more thorough and harmonised enforcement of existing investor protection regulations by the ESAs, by the NCAs and by private enforcement (pan-European collective redress scheme)
- Restoring easy access of individual investors to capital markets, shares and bonds especially, in particular by imposing the same investor protection and disclosure constraints on all market "venues" if they want to deal with any retail trades.



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