Consultation Response DACSI **15-1083**

Capital Market Union

DACSI's response to the European Commission's Green Paper
"Building a Capital Market Union"

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DACSI (the Dutch Advisory Committee Securities Industry) is the principal trade association in The Netherlands for firms active in the securities industry. The association represents the interests of its members as users/clients of infrastructure providers in the field of securities, e.g. exchanges, central counterparties, central securities depositories. With 11 members, DACSI represents the vast majority of the banks active in The Netherlands, and positions the Dutch view to the market infrastructure service providers and the regulatory authorities in The Netherlands and the European Union.

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Introduction

With this document we respond to the European Commission's consultation on the (further) development of the European capital market: the Green Paper titled "Building a Capital Markets Union". This consultation is part of the EC's agenda to expand the non-bank part of Europe's financial system. Its scope goes beyond that of DACSI, which focuses on post-trade issues, and hence DACSI can only contribute on selected issues.

Before narrowing down to post-trade issues and proposing our input for specific consultation questions we formulate our overall vision on the capital market from a DACSI perspective. Such a vision can enable us to formulate feedback on various consultation questions that is consistent with DACSI's overall vision and objectives. In the second half of this document we provide answers to selected questions.

The essential objective of the Green Paper initiative is to enlarge the possibilities for mobilising capital needed for economic activities by linking capital supply and demand in a single European capital market.
It is evident that creating complementary structures between users and providers of capital (end investors) implies a decrease of the market share of the traditional structures (chains of intermediaries, platforms and transformers). The current capacity of the existing structures is perceived inadequate to facilitate the demand for capital and hence hampering economic growth. In addition – or perhaps even more important – the political choice has been made to decrease the economy's dependence on the banking sector.
So, new ways have to be explored beyond the current structures and institutions, and the banks' challenge is to chart possibilities for new roles in this changing environment.

The intermediary role of banks

One of the key issues signalled in the Green Paper is that banks do not supply capital in the form of credit in adequate quantities and/or qualities. It should be noted that banks are not end investors by nature, but they transform capital provided by end investors (through savings accounts, deposits or loans) into credit for users of debt capital. Share capital has never been provided through banks' balance sheets to substantial amounts.
So, the message given in the Green Paper is that the chain using the banks' balance sheets – with banks acting as principal on both sides – is not adequate in meeting today's demand for debt (while it never did for equity), in particular for sme. The quintessence of this observation is that one should not only look for alternative sources of capital (i.a. through cultural and educational change), but also for alternative structures of the chains between – not necessarily alternative – providers (investors) and users (issuers).

Several initiatives have been started exploring alternative or new sources. The aim of our response is exploring possibilities of alternative structures between sources and users. Europe's challenge is defining and opening up these structures, while taking advantage of (most of) the work that has been done and still is being done in Europe in the last decades aiming at protecting investors (against issuers and intermediaries), securing transparency, assuring fair, orderly and efficient markets, etc.

We note that the issue described above – shortage of capital available for users – is not necessarily caused by the individual players in the intermediary chain, but merely in the way they interact, and probably also in factors close to the sources and users themselves. We only mention here the Prospectus Directive and the International Accounting Standards, which are highly relevant for capital users; they are being addressed elsewhere already.

Examples of what should be conserved in essence, possibly adapted to new circumstances: MiFID/MiFIR, CSDR, SLL, ShRD, Shadow Banking, Market Standards, ….

Most of the – individual and collective – interests addressed by these legislations and other initiatives are relevant in any capital market structure between providers and users, as well in the primary market as in the secondary market. This applies even when issuers and investors engage in direct formal relationships with each other.

When:
- issuance amounts are small (sme is in scope),
- investment amounts are small (many initiatives to mobilise capital from retail investors; also increasing need for investment possibilities for individuals as alternative for collective pension funds),

additional challenges will be faced:
- it will be difficult for the issuer to reach the potential investor (impossible or too expensive),
- it will be difficult for the investor to assess and monitor his potential investment.

We see a role for:
- “new” transformation/aggregation structures like (investment) funds or securitisation;
- intermediaries bridging the information gaps between players, like issuer agents, rating agencies;
- enhancements of the infrastructures, like liquidity providers on secondary markets.

Primary market

In the primary market (IPO), an intermediary (agency) role should be considered both at the issuer and at the investor side, either mandatory or voluntary.
Careful attention should be given to the consistency between formally independent, but essentially related pieces of regulation. In this context, we signal the (potential) conflict between the CMU initiative and MiFID. The first one suggests strongly stimulating private investors to invest in sme, while MiFID aims at protecting retail investors against the risks of (direct) investments in small entities. Especially, when particular documentation/information requirements are relaxed for sme – e.g. by means of light regimes for prospectus and/or accounting – this conflict will easily materialise.
This potential conflict can be mitigated by stimulating indirect investments – e.g. through investment funds or other collective structures – and by improving the possibilities of analysis and interpretation of (financial) information provided by the issuer – e.g. through mandatory involvement of rating bureaus or comparable agents.

Secondary market

Whatever the – new or amended – process in which providers and users have met initially in the primary market, and whatever the amounts involved, the need for safe and orderly infrastructures for the secondary market remains.
At the trading level, initiatives are being taken to tailor procedures to the need of sme and to ease cross-border investments.
In the post-trade sphere, the need for CCP clearing remains, guaranteeing investors a safe execution of their trades. And the rationale for the involvement of CSDs is equally valid in order to guarantee (i.a.) the integrity of the securities issued.

As an effect of the recent regulations (EMIR, CSDR) we expect that a significant consolidation will reduce the number of active CCPs and CSDs in the EU.
As in particular CCPs are becoming even more systemically important, strong dedicated regulation has already been started. One might argue that CCPs’ importance will grow to such levels, that the concept of commercially driven organisations will no longer be compatible with their pivotal role in the financial system.
We envisage a very small number of active CCPs that are all strongly regulated and supervised by one European institution, not by local authorities. In case this number would be reduced to one, a not-for-profit model would better fit the role of that single CCP than a profit driven organisation.

For CSDs we also envisage a strong further consolidation, driven mainly by efficiency. Risk plays a less important role for CSDs than for CCPs, but a further consolidation can go hand-in-hand with harmonisation of processes and will stimulate a single European market. Whether we will end up with one single European CSD highly depends on the ambitions of Target 2 Securities and of the main current CSD organisations.

Asset servicing

No matter how supply and demand have met initially, during the lifecycle of the securities/participations, asset servicing should take place: coupons or dividends have to be paid; other corporate actions (at least redemptions) have to be facilitated. In particular for equity, shareholder rights have to be exercised (General Meetings).

With regard to asset servicing: the existing infrastructure is designed for (large) cross-border investments, large volumes and frequent trades. At first glance, the new types of issues and investments may not require such a heavy (and expensive?) infrastructure. However, the main considerations for having the current (and future) infrastructure in its current (and future) shape are equally valid for the new issues. Corporate actions have to be processed; shareholder rights have to be exercised, regardless of the organisation and the size of the initial offering. In addition, it will be more cost effective to use a slightly over-designed existing infrastructure than designing a new one. The latter would carry substantial initial costs – carried by low-volume issues – and imply a breach of standardised processes.

In general, a focus on sme and a choice for alternative structures may require that regulatory or procedural requirements are less stringent. However, "light regimes" should focus on the content (of documentation, qualifications, ….) and on the parameters of processes. Processes themselves should not be differentiated as to ensure harmonised and efficient pre- and post-trade processes. This – and even further harmonisation – remains key for an efficient allocation of funds between providers and users.

Answers to selected consultation questions

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

Whatever the process in which providers and users have met initially (primary market), both sides have a strong interest in a concentrated secondary market. Fragmentation is not in the interest of the functioning of the capital market.

Unnecessary European rules and regulations should be dismantled and the different European rules and regulations should be streamlined as much as possible (e.g. reporting requirements under EMIR, MiFID and SFTR).

An overall condition for a single market is ensuring a level-playing field for all actors in financial markets where neither regulation nor other formalities prevent cross-border activity or distort competition.

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

Providers of funds (investors in debt or in equity) are attracted much stronger when processes and procedures – including investor protection measures – are harmonised; further implementation of market standards and removal of different local practices are a prerequisite.

Q 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?*

Investment funds should make use of the (infra)structures for securities. Current processing methods for funds – depositaries, trading, settlement, CA processing etc. – are not harmonised and unnecessarily diversified.
A regulatory boost for investment fund harmonisation needs amendments in both UCITS and AIFMD.

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

Investment fund participations should be organised and structured as ETFs and use the same post-trade routes as exchange traded securities. Huge efficiency gains are possible.

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

Consumer/investor protection in this context has two dimensions: 1. protection against making improper investment decisions, and 2. protection against intermediary failure.

Ad 1: we signal the (potential) conflict between the CMU initiative and MiFID. The first one suggests strongly stimulating private investors to invest in sme, while MiFID aims at protecting retail investors against the risks of (direct and/or undiversified) investments in small entities. Especially, when particular documentation/information requirements are relaxed for sme – light regimes for prospectus and/or accounting – this conflict will easily materialise. This potential conflict can be mitigated by stimulating indirect investments – e.g. through investment funds or other collective structures – and by improving the possibilities of analysis and interpretation of (financial) information provided by the issuer – e.g. through mandatory involvement of rating bureaus or comparable agents.

Ad 2: the European landscape sees a wide palet of local measures aiming at preventing that final investors are damaged by the failure of an intermediary (custodian, broker or agent). We have no specific doubt that these measures are adequate in a local context, but their effectiveness for foreign investors – in combination with different processes and positions for these foreigners – is not beyond doubt. Only harmonised rules reigning ownership, ownership acquisition, insolvency proceedings etc. have the potential of taking away the relevant obstacles.
We note that enforcing account segregation on the level of individual investors – as often advocated – is not an alternative for the harmonisation of securities and insolvency law. Such a mandatory segregation would be costly and would increase operational risk and they are not the dominant solution for the creation of investor protection.

Q 21 *Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?*

CCPs and CSDs should be regulated by fully European frameworks – going beyond the current EMIR and CSDR – and supervised by one European organisation.

Q 23 *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?*

We think the following is important:

- harmonised pre- and post-trade processes,
- one single currency,
- efficient use of collateral (see Q 27),
- harmonisation of tax rules,
- one business language.

Q 26 *Taking into account past experience, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets within the EU?*

We regard the following as essential:

- harmonised rules of how securities and collateral are acquired in legal terms,
- implementation of conflict of law rules in relation to holding, acquisition and disposition of securities and collateral,
- harmonised insolvency rules, e.g. insolvency of intermediary and segregation of its clients securities and collateral from its own assets,
- harmonised EU laws to ensure that any assets deemed as eligible collateral can be utilized across border without impediment,
- improved cross-border ownership conditions,
- more widespread use of close-out netting,
- streamlined segregation requirements over EU and over several regulations,
- improved transparency over the chain of ownership in securities.

Q 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?*

We recommend:

- a review of recent regulatory measures (MiFID, EMIR, SFTR) and the removal of unintended obstacles,
- further harmonisation of methods of creating collateral (harmonisation of insolvency laws, incl. close-out netting),
- streamlining of eligibility rules,
- codification of collateral recovery.

Q 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?*

Some further measures that can help overcoming obstacles are:

- quick implementation of the Shareholder Rights Directive,
- streamlining of – currently local - minority shareholder protection schemes.