EUROCHAMBRES Position on the new Capital Markets Union Action Plan

EUROCHAMBRES welcomes the European Commission's efforts to deliver a new Capital Markets Union Action Plan focused on increasing cross-border capital flows, provide more funding sources for businesses, and improve the European Union's financial ecosystem. The crisis resulting from the lockdown measures in response to COVID-19 has had a significant negative impact on SMEs' ability to trade and access to finance has become even more crucial for the recovery.

Nevertheless, Chambers believe that the CMU remains more of an aspiration than a reality in terms of delivering what it had already promised to SMEs back in 2015. The same fundamental challenges remain:

- **Underdevelopment of capital markets ecosystems and cross-border investments,**
- **High reliance on bank lending, and**
- **High risk averseness when it comes to investing in innovative start-ups and scale-ups.**

Despite the inclusion of some initiatives designed at addressing the specific challenges faced by SMEs, we feel that the Action Plan could have been more ambitious when it comes to tackling the high costs and administrative burdens for small companies, encouraging a diverse and attractive funding base, as well as addressing the overall lack of capital markets culture.

Chambers stand ready to support all measures and initiatives that accelerate recapitalisation and allow SMEs to swiftly raise capital necessary for their recovery and growth.

Action 1: Setting up a European Single Access Point (ESAP) that provides access to financial and sustainability-related company information

Chambers support the establishment of a centralised, EU-wide digital access platform for companies to publicly report financial and non-financial information. We are aware of the requests from investors who may be interested in building SME equity portfolios based on robust, comparable, and reliable Environmental, Social and Governance (ESG) data. However, this important contribution from companies towards achieving the sustainability objectives in line with the ambitions of the Paris Agreement and the European Green Deal, must be carefully assessed by considering the technical formats and processes involved. EUROCHAMBRES welcomes the effort to achieve comparability but excessive reporting obligations and costly digital formats, e.g. XBRL, should be avoided.

ASSOCIATION OF EUROPEAN CHAMBERS OF COMMERCE AND INDUSTRY ASSOCIATION
DES CHAMBRES DE COMMERCE ET D'INDUSTRIE EUROPEENNES
Chamber House, Avenue des Arts, 19 A/D B - 1000 Brussels / Bruxelles • Belgium / Belgique
Tel. +32 2 282 08 50 • eurochambres@eurochambres.eu • www.eurochambres.eu
Transparency Register number: 0014082722-83

Furthermore, ESAP needs to take into account the information coverage, reception, and impact on capital markets. Preparers of financial and non-financial information need to be adequately consulted and represented in the governance of ESAP.

Action 2: Promoting and diversifying small and innovative companies' access to funding

Following the last financial crisis, the adoption of a "one-size fits all" approach led to an investment cutback in small and mid-caps and capital markets overall. Initial Public Offering (IPO) activity in Europe has been moderate and rather volatile over time and barely exists for SMEs[1] with market-based sources of finance such as bonds and shares becoming rarely used. Fewer retail and institutional investors are willing or able to invest in smaller companies on stock markets. Furthermore, costs for entering public markets (e.g. bank fees, advisory and auditing services, roadshows, costs, prospectuses, paperwork, and communication) are largely fixed and discourage smaller players from doing so.

We believe there is a need to develop an ecosystem that supports SMEs in reaching their full potential. Such refocusing effort would allow expanding access to finance for SMEs by offering capital formation possibilities before and beyond the IPO phase by revising relevant legislation. EUROCHAMBRES highlights the need to alleviate listing rules and administrative costs in the Prospectus Regulation and the Market Abuse Regulation for companies that want to access public markets, while ensuring that relevant information is communicated to potential investors. Chambers agree with the Capital Markets Union High Level Forum's recommendation calling for a transitional approach that spares newly listed companies on public markets from full legal compliance from the onset, allowing the financial cost to be gradually spread over a certain period.

EUROCHAMBRES also believes that companies listed on MTFs, including SME Growth Markets, should be able to retain national accounting standards. The obligation for small companies to switch to IFRS would be a major hurdle and would detract business owners from even considering accessing public capital markets.

Alternative forms of financing provided by actors such as institutional investors, venture capital funds, and other intermediaries, need to be backed up by strong policy measures in favour of SMEs as well as additional forms of co-financing brought by the European Investment Fund, InvestEU, Horizon Europe, and other funding sources. Given the decrease of risk capital in Europe, alternative forms of equity or mezzanine capital would be particularly valuable for SMEs, especially those involved in innovative projects and products that embrace digitalisation and sustainability. The legislators should also improve SME funding conditions by introducing new EU standards and labels such as passport schemes for lenders to overcome cross border barriers, loan originating funds, and secured notes.

Chambers welcome the introduction of a public-private fund dedicated to support small companies IPOs. Such fund, or "fund of funds", should channel private investment together with the support from the European Investment Bank towards innovative,

[1] https://www.ceps.eu/ceps-publications/developing-eu-capital-markets-smes-mission-impossible/

growth companies, while releasing additional lending capacity to micro and small enterprises. The fund could also enhance equity research on SMEs by promoting their visibility towards business angels, retail, and institutional investors. In addition, it could also provide secondary market liquidity to companies, in the absence of a wide shareholder base and large free float, to guarantee smooth trading, control liquidity risk and prevent volatile or underperforming share prices. This could foster greater confidence for investors and mitigate risk when investing in promising start-ups who wish to scale up.

To stimulate equity markets and reduce the existing debt bias in the EU, EUROCHAMBRES believes there is a pressing need to improve institutional and retail investors' ability to invest through fiscal arrangements that benefit all actors in terms of capital gains, dividend payments and risk taking. The double taxation of equity should be removed in Member States where it exists. In economies with mature debt markets, policy makers could consider changing the tax treatment of equity in order to remove the bias against capital gains.

Action 3: European Long-term Investment Funds (ELTIFs)

Chambers consider that ELTIFs are crucial instruments for increasing the amount on non-bank finance for companies investing in the real economy. However, its legal framework needs to be improved to make these infrastructure investments more attractive for institutional investors. ELTIFs could represent a valuable investment and diversification opportunity, in line with the objectives of the CMU and the European Green Deal, depending on their asset allocation. We welcome the refinement of the rules by softening existing investment restrictions, answering to individual investment needs, and more flexibility with respect to investor protection rules.

Action 4: Encouraging more long-term and equity financing from institutional investors

A.

Institutional investors are often deterred from investing in SMEs due to minimum investment sizes of portfolios, the small size of available shares and documentation required. EUROCHAMBRES has argued for encouraging insurance companies to invest in small and mid-caps by making targeted improvements to Solvency II to improve equity and debt capital calibrations and to promote long-term investment. The review announced by the European Commission provides an opportunity to remove the unnecessary constraints related to the provision of long-term products and investments and stimulate growth in the single market.

European insurance companies now invest less in equity when compared to the level reached before the last financial crisis. Under the Solvency II regime, insurers must, in most cases, hold a 39% standard capital charge to own shares in listed companies while debt-related instruments are in practice less expensive since they are subject to a capital charge of 15%. Level of investments by pension funds into equity remains low compared to its potential. Chambers invite lawmakers to investigate ways as to increase the long-term view of investments for insurance companies to generate a meaningful contribution to the stabilisation of the economy.

Furthermore, the differences in solvency capital requirements between senior and non-senior tranches of a securitisation remain high. The calibration of solvency capital requirements could be revised to align senior tranches credit spread shocks with those for bonds and loans for all credit rating levels.

EUROCHAMBRES defends that:

- The criteria of the new long-term equity investment should be reviewed by removing unnecessary barriers to investing in equities and support increased equity allocations within portfolios;
- A dynamic volatility adjustment mechanism should be included in the standard formula to align debt capital charges with the true risks that insurers face when holding corporate bonds over the longer term;
- Enhancement to the Risk Margin (RM) and Volatility Adjustment (VA) calculations to further increase insurers' investment capacity.

A stable extrapolation method and improvements to the VA and RM could reduce undue volatility and increase insurers' risk capacity. The review of the Solvency II rules should also consider the lessons learnt from the last financial crisis. EIOPA has highlighted that the sector is well capitalised and able to withhold severe shocks to the system thus Solvency II's artificial volatility needs to be addressed as soon as possible. This is important for guaranteeing the insurers' contribution towards Europe's economic recovery.

We also welcome the recommendation on pursuing further discussions at the IASB to address the flaws in the accounting treatment of insurers, to ensure that their long-term investment horizon is better reflected. This issue has been highlighted in EFRAG's advice to the EC in January 2020.

B.

Traditional bank debt remains the main source of financing for SMEs in Europe. Following the introduction of Basel III and in the context of credit tightening after the financial crisis, a capital reduction factor for bank loans to SMEs – the so-called SME Supporting Factor – was introduced by the Capital Requirements Regulation (CRR). However, there are concerns with the implementation of Basel III in the way it could affect bank-based financing and the range of services catered to SMEs.

EUROCHAMBRES believes that some improvements in the regulatory framework, when it comes to the finalisation of Basel III and the implementation of Basel IV, could spur bank lending to SMEs, without putting the financial stability at risk. When transposing Basel IV into European law, the Commission should consistently uphold the principle of proportionality. The aim should be to maintain SMEs' access to finance in terms of volume, type, and quality of banking services.

- The SME Supporting Factor has been crucial for guaranteeing access to finance and EUROCHAMBRES welcomes the advance of the date for its application against the backdrop of nowadays' difficult economic conditions and invites the Commission in permanently establishing it in EU law;
- The introduction of a new methodology for the risk weighting of SMEs within the

ASSOCIATION OF EUROPEAN CHAMBERS OF COMMERCE AND INDUSTRY ASSOCIATION
DES CHAMBRES DE COMMERCE ET D'INDUSTRIE EUROPEENNES
Chamber House, Avenue des Arts, 19 A/D B - 1000 Brussels / Bruxelles • Belgium / Belgique
Tel. +32 2 282 08 50 • eurochambres@eurochambres.eu • www.eurochambres.eu
Transparency Register number: 0014082722-83

asset class "corporates" is not necessary nor should the proposed higher risk weight for companies in the construction industry be incorporated in EU law;

- EU laws should not make it more difficult for credit institutions to grant loans to SMEs. Smaller SME-oriented regional banks with relatively few borrowers may have problems in staying below the current lending volume limit for their individual borrowers;
- Lawmakers should also not make equity financing more restrictive. There are no indications that the investment risk related to equity has systematically increased. When the risk-weighting is set at an appropriate level, the financial efficiency of equity investments by banks in smaller companies is raised, attracting additional investors. The banks' withdrawal from market making activities should therefore be avoided and any reinterpretation of "speculative unlisted equity exposures" should not hinder investment in long-term SME equity.

Particular attention should be paid to the interpretation of the Basel III definition of 'speculative unlisted equity exposures' so as not to impair the ability of banks to invest in long-term equity on terms which are economically efficient and prudentially appropriate.

Action 7: Empowering citizens through financial literacy

Financial education has a crucial role in ensuring that not only European citizens, but also business owners, are equipped with knowledge, confidence, and skills necessary to make sound financial decisions and strengthen their financial position. However, achieving well-being through long-term investments in capital markets is hindered by a series of factors: low financial literacy, unfamiliarity with the capital markets modus operandi, lack of awareness in the financial consumer protection framework linked to financial products, structural biases related to Member States' policies.

Risk awareness is a fundamental element in financial education. While existing investors should base their decisions to hold financial assets fully aware of the risks, rewards and market fluctuations, prospective investors may need to rely not only on objective, professional advice but also on gaining the necessary skills to understand the importance of risk diversification and the benefits of long-term investment planning. In so doing, it expands their scope of choice and allows them to make informed decisions when selecting the products that meet their expectations and needs.

EUROCHAMBRES sees the recognition of financial knowledge and skills as a priority and encourages Member States to support financial education based on formal, non-formal and informal learning measures. Given that the financial literacy landscape across the EU is quite varied, the Commission could invite Member States into developing national strategies focused on financial awareness for consumers, extending the principle enshrined in Article 6 of the Mortgage Credit Directive to other sectorial legislation covering e.g. mortgage credits, life insurances, personal pension products or packaged retail and insurance-based investment products. The Commission could drive Erasmus+ towards supporting financial awareness targeting young people, as well as other programmes and initiatives through digital means.

Businesses owners could also profit from more training, networks and increased financial expertise. Chambers would welcome the establishment of national platforms that facilitate exchange of financial experience, bringing together business owners and business angels, promotional banks and business incubators and accelerators.

Finally, and following the example of the French “Loi Pacte”[2], Chambers also invite the Commission to incentivise Member States to use employee share ownership schemes concerning both publicly owned companies and private companies.

Action 8: Applicable rules regarding inducements, disclosure, fair advice and comparable products

MiFID II brought a number of requirements on financial companies on how they communicate and report on their activities, measures to identify, prevent and manage potential conflicts of interest, prohibition on commissions and inducements, unless they are designed to enhance the quality of services to retail investors and do not impair the companies’ duties to act fairly and professionally in the portfolio management. In order to make investment in securities more attractive to and to reach a larger pool of retail investors, EUROCHAMBRES is not against the Commission conducting further analysis on inducements in the adequacy of advice, and exploring a potential cross-sectorial alignment in particular with the Insurance Distribution Directive (IDD), aimed at improving the customers’ understanding of these procedures. However, Member States should be allowed to maintain their own distribution systems and be allowed to operate different commission models as long as retail clients’ access to advice is not negatively affected.

Chambers believe that bans on inducements would not be beneficial to consumers and could in fact be circumvented by financial operators through “vertical integration practices” between banks and asset managers and only group products might be offered to end-clients, as indicated by ESMA[3]. Furthermore, a ban on inducement could result in the dissemination of the fee-based independent advice sector, a ground-breaking market shift that would destabilize Member States’ in which retail banking business models prevail. Finally, the introduction of an obligation for distributors to inform clients of the existence of third-party products is not needed due to the existing obligation to provide appropriate, professional advice.

EUROCHAMBRES notes that, to ensure a proper level of knowledge and suitability, many Member States require the professional certification of advisers providing investment advice and portfolio management, and in accordance with EU law (e.g. Article 10 of IDD). Though EU guidance containing recommendations for market operators who offer advice would be welcomed, the Commission should refrain from imposing additional, compulsory professional qualifications’ constraints on the existing workforce due to the negative consequences these could bring for the administration and audit departments.

Action 9: Supporting people in their retirement

Chambers welcome EU-level initiatives that facilitate the adequate funding of pension

[2] That brought forward the reform of retirement savings, employee savings for all SME/micro-businesses and the development of employee share ownership – more information here
[3] https://www.esma.europa.eu/press-news/esma-news/esma-advises-european-commission-inducements-and-costs-and-charges-disclosures

systems while mitigating risks and interact with the wider national pension and tax structures. It is important to stimulate the 2nd pillar of pensions systems (Private supplementary plans linked to an employment relationship) and to create a sustainable integrated pension system by also strengthening the 3rd pillar (personal pensions) and exploit the full potential of the capital markets union. Only an integrated three-pillar pension system will allow for maintaining adequate risk balance for citizens in their retirement.

Pension systems differ substantially from country to country. Individuals should have the possibility to choose the most appropriate retirement provision. National circumstances should be considered when discussing the introduction of auto-enrolment schemes while upholding a level playing field between different providers. Auto-enrolment should not lead to the discrimination of 3rd pillar pension products.

Action 11: Insolvency proceedings

A sound and predictable legal environment is essential to encourage investors to engage on a cross-border investment plan. However, the Commission should be reminded that insolvency proceedings of insurers are already harmonised quite substantially according to Solvency II, particularly in terms of the required involvement of national supervisory authorities and the privileged treatment of policyholder claims. Chambers believe that a minimum harmonisation or increased convergence of national insolvency system in targeted areas within the Single Market is not necessary and could, in fact, violate the EU's subsidiarity principle. If the Commission goes ahead with a new framework for harmonising insolvency laws in the EU, a detailed comparison of legal systems is fundamental.

Member States with functioning insolvency systems could share best practices in terms of procedures with their counterparts. Forum shopping and insolvency tourism could be prevented by revisiting the rules on applicable law and jurisdiction.

Action 15: Investment Protection and Facilitation

EUROCHAMBRES believes that investor-state arbitration provisions have in the past ensured that investors' rights are effectively enforced against discrimination, expropriation, unfair treatment and arbitrary measures arising from host Member States.

The Achmea case ruling makes it clear that an EU-wide legal framework for investment protection in terms of intra-EU agreements is fundamental to guarantee corporate growth, competitiveness, and employment in the Single Market. European investors, national administrations and courts need a codified, future-proof set of rules that increases investment protection rights in the Union. The focus should be on a simple, fast, effective, cost-efficient, and SME-friendly system, in conformity with EU law and facilitating access for investors from all EU Member States.

An additional, easy-accessible cost-efficient amicable dispute resolution mechanism can also be further developed. A network of national contact points, supported by the EU Commission, could inform investors, particularly SMEs, of their rights and the available procedures and support the dialogue with the host State. Such a structured exchange between investors and authorities helps the parties to better understand the specific circumstances of the case and make the interests at stake more tangible. The mechanism could include best practices from existing support services (e.g. investment agencies, SOLVIT, the Enterprise Europe Network (EEN), the Chambers network). It must be well equipped and have sufficient and well-trained staff to deal with these complex cases.

Furthermore, voluntary negotiations, mediation or conciliation should be promoted to resolve the dispute before the company initiates arbitration or legal proceedings and to avoid the investor leaving the host State. If successful, they could reduce costs and the duration of proceedings and reduce the number of cases in which a court or conciliation procedure becomes necessary.

Chambers also agree on improving the investment climate and the implementation of EU law on establishment and free movement of capital, e.g. via more cooperation and exchange of best practices on effective cross-border judicial protection as well as strengthening the rule of law and infringement proceedings.

EUROCHAMBRES – The Association of European Chambers of Commerce and Industry represents over 20 million enterprises in Europe – 98% of which are SMEs – through 45 members and a European network of 1700 regional and local Chambers.

Further information: Mr Frederico Martins, Tel. +32 2 282 08 54, martins@eurochambres.eu
Press contact: Ms. Agatha Latorre, Tel. +32 2 282 08 62, latorre@eurochambres.eu