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A New Vision for Europe's Capital Markets – Final Report of the High Level Forum

The High Level Forum (the "**HLF**") set up by the European Commission has earlier this month published a report on the creation of a true single EU capital market (the "**Report**"). In light of the COVID 19 pandemic, the exit of the UK from the EU, the focus on sustainable finance and the need to provide sustainable pensions, it was noted that there is an urgent requirement to rebuild the European economy and the development of a single EU capital market is necessary in light of the various immediate and prospective financial challenges affecting the EU.

The requirement for a single EU capital market is precipitated by, amongst other things, the fact that bank lending alone will not be sufficient to support the funding requirements of the European economy. The fragmented approach across the EU will adversely impact the EU recovery and place the EU at a disadvantage relative to other economies. In particular the costs of securities issuances and the regulatory hurdles faced by market participants due to variances in national rules exacerbate the lack of cross border investment and the more efficient distribution of capital throughout the EU. The fragmentation of the EU capital markets prevents the creation of economies of scale. This fragmentation is due to a number of factors including different tax and insolvency regimes and divergences in regulatory supervision. These differences and the associated costs in addressing them are amongst the primary contributors to the lack of capital market integration. It is argued in the Report that a reduced investor base caused by these variances inhibits local capital markets' capacity (particularly for smaller Member States, like Ireland) to offer liquid trading conditions and efficient price discovery. The Report recommends that the convergence of tax, insolvency and supervisory regimes will create a more level playing field, more efficient markets, will result in lower costs and create opportunities for more market participants to fully

For further information on any of the issues discussed in this article please contact:

Keith Robinson
Partner, Banking & Capital Markets
DD: + 353 (0)1 674 1004
keith.robinson@dilloneustace.ie

utilise the benefits of the single market. However there are differences within the HLF as to whether the consolidation of supervision would generate the benefits suggested in the Report.

At a more micro level, the lack of access to the capital markets results in households placing their savings in banks which does not foster long-term wealth creation resulting in inadequate pension provision for households in general and in particular lower income households. The complexity of investment information and a dearth of adequate advice perpetuates the underutilisation of long term investments. The Report argues that a larger presence of long-term investors would bring considerable benefits to these markets, and at the same time contribute to more efficiency and growth of market-based financing creating economies of scale and thus mirroring the important role pension funds have played in the development of capital markets in the US, United Kingdom and Netherlands. Raising awareness of the need for individuals to make adequate provisions for their future retirement income, for example through individual consolidated annual pension statements, and increasing the understanding of appropriate forms of long-term investment will encourage them to seek suitable solutions and invest in suitable products. Key to this is putting measures in place that enhance the financial literacy of consumers and investors through training of financial advisors and other initiatives.

It is argued that a capital markets union is required to bolster the international role of the euro in a more competitive international market in a manner that benefits the EU in general through better reallocation of wealth, pension protection and more transparent. Key to this is the scaling up of the European securitisation market. The Report notes that securitisation has played a very limited role in Europe over the last decade. Due to the increase in bank capital requirements under Basel III, the Report provides that these requirements must be met through, amongst other things, the sale of assets and/or securitisation with the probable need for new RMBS issuances over the coming decade being estimated to be €800bn. There are seven key recommendations that specify what is required to augment the European securitisation market which include an ambitious suite of legislative amendments to a number of key EU regulations.

The Report identifies a number of issues that are barriers to entry for markets based financing, including a bias towards debt financing rather than equity financing and high costs of legal compliance. These factors adversely impact the ability of smaller companies access to capital. This access is further impaired by lack of accessible, reliable and comparable public information and this is more pronounced in smaller Member States such as Ireland.

To lower these competitive disadvantages and barriers to entry the Report made 17 recommendations. The Report recommends that the European Commission:

- creates a single point of access through the creation of interconnected national and EU registers and databases of company information;

- proposes some sound amendments to encourage significantly higher investment particularly in equity, including in SMEs, by (i) carrying out a targeted review of Solvency II and (ii) paying due attention to provisions affecting market making and long-term investment in SME equity by banks and non-banks, when implementing the Basel III standards;

- implements a series of targeted, prudentially sound amendments are implemented to improve the EU securitisation framework;

- introduces targeted modifications of, in particular, the prospectus, market abuse and MiFID regulatory framework to make public listing more attractive in particular to SMEs;

- (i) puts forward a proposal for a shareholders' rights regulation providing a harmonised definition of 'shareholder', (ii) amends the shareholders' rights legislation to clarify and harmonise the interaction between investors, intermediaries and issuers with respect to the exercise of voting rights and corporate action processing and (iii) in cooperation with national competent authorities, facilitates the use of technology to enable wider investor engagement (thanks to an easier exercise of shareholder rights) and to make corporate action processes more efficient;

- (i) develops voluntary contractual standard clauses to enable financial institutions to better assess and manage risks related to their reliance on cloud services providers, (ii) develops a harmonised legislative framework to ensure the secure use of those services and (iii) improves the digital competitiveness of the EU by encouraging the development of EU cloud providers;

- (i) develops a dashboard to measure Member States progress on pension adequacy and sustainability, (ii) encourages the development of pension tracking systems for individuals, and (iii) supports the introduction of auto-enrolment systems to stimulate adequate pension coverage across all Member States;

- introduces a harmonised open finance e regulatory framework covering financial and non-financial information relevant to facilitating financial planning or encouraging investment;

- puts forward a legislative proposal to introduce a standardised system for relief at source of withholding tax based on authorised information agents and withholding agents;

- adopts a legislative proposal for minimum harmonisation of certain targeted elements of core non-bank corporate insolvency laws and, in cooperation with European Banking Authority, undertake further initiatives and

- strengthens ESMA and EIOPAs' mandate to enhance EU supervisory convergence, including by reforming their governance and strengthening their powers and toolkits as well as by entrusting them with wider powers in crisis management and ensuring that they are granted adequate resources. To that effect the Commission should review the relevant sector-specific legislation as well as the founding Regulations of ESMA and EIOPA.

Conclusion

The 121 page Report outlines and compelling, considered and ambitious plan for the creation of a true single market for capital. However, the number of changes that will be required to existing legislation and in particular the proposal for more tax harmonisation may cause concern for numerous Member States. This ambitious plan will require significant management of the Member States to ensure its implementation.

Dillon Eustace

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DILLON EUSTACE

Dublin
33 Sir John Rogerson's Quay, Dublin 2, Ireland. Tel: +353 1 667 0022 Fax: +353 1 667 0042.

Cayman Islands
Landmark Square, West Bay Road, PO Box 775, Grand Cayman KY1-9006, Cayman Islands. Tel: +1 345 949 0022 Fax: +1 345 945 0042.

New York
245 Park Avenue, 39th Floor, New York, NY 10167, U.S.A. Tel: +1 212 792 4166 Fax: +1 212 792 4167.

Tokyo
12th Floor, Yurakucho Itocia Building, 2-7-1 Yurakucho, Chiyoda-ku, Tokyo 100-0006, Japan. Tel: +813 6860 4885 Fax: +813 6860 4501.