

High-Level Forum Report on the Capital Markets Union: ICMA Feedback

On behalf of the International Capital Market Association (ICMA), we are pleased to provide feedback regarding the European Commission’s high-level forum “HLF” report on Capital Markets Union. ICMA is grateful for the opportunity to respond to the Commission’s call for feedback. In particular, the Taskforce welcomes the opportunity to provide feedback on HLF recommendations regarding EU single access point, European long-term investment funds (ELTIFs), market-making and re-equitisation of the market, scaling up the European securitisation market, improving the public markets ecosystem, central securities depositories (CSDs), shareholder identification, exercise of voting rights and corporate actions, financial literacy/education and investment culture, distribution, advice and disclosure, withholding tax, insolvency, supervision and finally EU bond consolidated tape.

Recommendation 1: An EU Single Access Point

Do you agree that recommendation 1 is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don’t know / no opinion / not relevant

If you disagree with all or part of recommendation 1, how would you amend it?

ICMA recognizes the advantages of an EU-wide digital access platform for companies’ public financial and non-financial documents (a European EDGAR) – if appropriate filtering functionality is provided. In introducing the ESAP, careful consideration would need to be given to the cost/benefit analysis associated with any new requirements for companies to adopt new or more extensive use of machine-readable data in the short-term (e.g. in disclosures under the Prospectus Regulation). In this respect, it is worth noting that further regulatory requirements for prospectus information to be in machine-readable format (even under a ‘file only once’ principle) risks requiring (i) an element of standardisation (which can restrict borrower flexibility to access capital market funding) and (ii) borrowers to have coding resources (which can significantly increase the cost and so reduce the attractiveness of borrowers accessing capital market funding). Also, it is not clear how this initiative would interact with the European Financial Transparency Gateway (EFTG) project. See further [ICMA’s 25 June response](#) to the Commission’s consultation on an EU Digital Finance Strategy (at questions 27/28).

Recommendation 2: European Long-term Investment Funds (ELTIFs)

Do you agree that recommendation 2 is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

If you disagree with all or part of recommendation 2, how would you amend it?

Retail investors: The review should be the opportunity to assess how the combination of strict investment limits (entry ticket, portfolio size and exposure limit to ELTIFs) and the application of suitability and target market rules has largely prevented the distribution to retail investors. Given the diversification and distribution rules, which protect investors, it would not be inappropriate to delete the mandatory minimum entry ticket (decided by the ELTIF manager) and amend the 10% investment limit.

Institutional investors: A detailed portfolio composition and diversification rules are counterproductive for professional investors, which can opt for AIFs or a bespoke portfolio within an individual mandate. We would therefore recommend exempting Professional ELTIFs from the application of some of the provisions of Article 13.2.

Eligible assets: (1) **Small caps:** The eligible investments include listed companies up to a capitalisation of €500 million. Given that the current average market capitalization on the MSCI Europe small cap index is \$1.3 billion (€1.18 billion) it might be appropriate to raise this threshold. (2) **Fund of funds:** we would also suggest allowing for the underlying fund to invest in a small bucket of non-eligible assets (< 10%).

Encumbrances: If asset encumbrances limit were set in order to be in line with the 30% limit applied to the borrowing of cash, it is market practice for lenders to require security that exceeds the amount borrowed – in order to better manage credit risk. Therefore, we believe that the 30% limit imposed by Article 16 1 (e) should be increased sufficiently to offset this market practice limitation.

Tax treatment: The “New” ELTIF should benefit at pan-European level of the best preferential tax treatment allowed for local AIFs. At the global level, we believe implementing a “TRACE 2.0” to reduce the administrative barriers that currently affect the ability of investors to access the tax treaties to which they are entitled.

Recommendation 4: Market-making and re-equitisation of the market

Do you agree that recommendation 4a is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

Do you agree that recommendation 4b is important?

- 1 - Not important at all
- 2 - Rather not important

- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / **no opinion** / not relevant

If you disagree with all or part of recommendation 4, how would you amend it?

ICMA fully supports the recommendations of the HLF to recalibrate the application of Basel III measures with respect to market-making, as well as ensuring a globally level playing field. Capital and liquidity constraints on market-makers in fixed income, including those related to accessing financing and hedging markets, have long been recognized by [ICMA](#) and [others](#) as negatively impacting secondary market liquidity by limiting the capacity for intermediaries to hold inventory.

ICMA's report, [Time to Act](#) illustrates that one of the two most significant risks to the future state of liquidity in the European corporate bond market, as identified by both buy-side and sell-side participants, is the expected increased capital costs for market-makers, related to Basel III and FRTB measures (the other being the CSDR mandatory buy-in regime). In its 2017 [Report](#), the European Commission's Expert Group on Corporate Bonds also identified disproportionate capital and liquidity costs as being one of two main factors that threatened bond market liquidity (the other being CSDR MBIs). The Expert Group made similar recommendations with respect to capital and liquidity rules.

While ICMA therefore welcomes the recommendations related to banks' prudential framework with the objective of supporting market making activity, it is somewhat surprised, and disappointed, that the HLF felt unable to make a recommendation with respect to the projected CSDR-SD regime, particularly in light of widespread market concerns about the design of the MBI framework. Not only would this seem to be completely out of step with [market opinion](#), but it undermines the constructive recommendations related to banks' prudential framework.

See also answer to Question 8.

Recommendation 5: Scaling up the European securitisation market

Do you agree that recommendation 5a is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important**
- Don't know / no opinion / not relevant

Do you agree that recommendation 5b is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important

5 - Very important

Don't know / no opinion / not relevant

Do you agree that recommendation 5c is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important

5 - Very important

Don't know / no opinion / not relevant

Do you agree that recommendation 5d is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral

4 - Rather important

5 - Very important
Don't know / no opinion / not relevant

Do you agree that recommendation 5e is important?

- 1 - Not important at all
- 2 - Rather not important

3 - Neutral

4 - Rather important
5 - Very important
Don't know / no opinion / not relevant

Do you agree that recommendation 5f is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral

4 - Rather important

5 - Very important
Don't know / no opinion / not relevant

Do you agree that recommendation 5g is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral

4 - Rather important

5 - Very important
Don't know / no opinion / not relevant

Recommendation 6: Improving the public markets ecosystem

Recommendation 6g: Alleviations to the Market Abuse Regulation

Do you agree that recommendation 6g is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

Recommendation 6h: Alleviations to the Prospectus Regulation

Do you agree that recommendation 6h is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

If you disagree with all or part of recommendation 6, how would you amend it?

Indeed only essential information for identification should be in **insider lists**. See [ICMA Nov 2019 response](#) to ESMA MAR CP (Q45).

The **inside information** definition is indeed broad – see Nov 2019 response (Q13-Q15). ICMA has been unable to consult on the proposed change regarding “significant price effect” at CMU HLF Report p.72. Incidentally, allowing issuers not to disclose “preliminary” inside information will not impact insiders (still treating it as other inside information). It is accepted (without prejudice to announcement obligations) that information on the internet is not inside information – see [ICMA Primary Market Handbook](#) (App.A12, #22): “Under the EU’s market abuse rules, information ceases to be unpublished price-sensitive information once it has been made public in any way.”

Prospectus length limits complicate rather than simplify borrower access to capital markets. Borrowers must meet a legal disclosure standard (all information material to investment decisions) with civil liability. This is not limited by document length: ‘materiality’ depends on the securities and borrower’s business (which may be complex) – not just what fits in the first 10, 100 pages... But allowing incorporation by reference of a wider range of contemporaneous information, and specified future information (rather than requiring supplements that duplicatively lengthen prospectuses), would help shorten disclosure (see [ICMA May 2015 response](#) to Commission PD CP, Qs.23-26, 40(c)/(e) and appended letter #20). It is unclear otherwise how reducing length is not detrimental to investors/issuers.

Recommendation 8: Central Securities Depositories

Do you agree that recommendation 8 is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / **no opinion** / not relevant

If you disagree with all or part of recommendation 8, how would you amend it?

Please refer to the response to Question 4: Market-making and re-equitisation of the market.

As illustrated in ICMA's 2019 [Impact Study](#), the MBI regime is widely expected to have a direct and significant detrimental impact on European bond market liquidity, since it provides a material deterrent to market makers showing offers in bonds that they do not hold in inventory. The impacts on pricing and liquidity are likely to be most felt in the case of less liquid securities (credit, high yield, emerging markets, SME securities, lesser traded sovereign bonds). A reduction in secondary market liquidity does not only create costs, and risks, for investors in EU securities markets, this also has implications for primary markets, with the possibility that issuers, both sovereign and corporate, will have to incur larger liquidity discounts to access the EU capital markets. For smaller potential issuers (such as SMEs, this could prove to be a barrier to entry).

Given that one of the objectives of the CMU is to widen and deepen capital market funding opportunities for corporates, in particular SMEs, so reducing the reliance on bank funding, it would seem almost incongruous that the HLF felt unable to make a recommendation on a price of regulation that is almost universally recognized as undermining this objective. Furthermore, no such regime exists in other major global capital markets (such as the US or [UK](#)), thereby creating an 'uneven playing field' and disadvantaging investors and issuers that participate in EU markets.

ICMA, and most likely the wider market, would be very interested to see the minutes of the HLF discussions on the topic of CSDR-SD to garner a better understanding of why it could not achieve a consensus view or provide a constructive recommendation, given the significance of this regulatory initiative for the development of European capital markets.

Recommendation 9: Shareholder identification, exercise of voting rights and corporate actions

Recommendation 9a

Do you agree that recommendation 9a is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral**
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

If you disagree with all or part of recommendation 9, how would you amend it?

Though ICMA has no views on the **definition of “shareholder”** as an equity rather than a debt concept, ICMA has previously expressed views around the definition of “bondholder” where bonds are immobilised in a clearing system: namely that a borrower’s payment to the clearing system depository as formal bondholder constitutes good discharge of that borrower’s debt obligation (with a similar principle relating to notifications). See [ICMA June 2009 response](#) to Commission CP on legal certainty of securities holding and dispositions, and [ICMA June 2017 response](#) to Commission CP on conflict of laws rules for third party effects of transactions in securities and claims.

Recommendation 12: Financial literacy/education and investment culture

Recommendation 12e: Financial guidance

Do you agree that recommendation 12e is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important**
- 5 - Very important
- Don’t know / no opinion / not relevant

If you disagree with all or part of recommendation 12, how would you amend it?

ICMA would agree with the recommendation for measures to improve **financial literacy** and engagement. In this respect, authorities at the appropriate level of subsidiarity (given tax and other official saving/investment incentives operate at the national level) could indeed consider giving generic public **guidance** on what kinds of product ranges typical consumer categories should consider in first instance, as seems to be suggested at pp.90-91 and pp.94/95 of the CMU HLF Report.

Recommendation 13: Distribution, advice and disclosure

Recommendation 13a: Inducements

Do you agree that recommendation 13a is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral**
- 4 - Rather important
- 5 - Very important
- Don’t know / no opinion / not relevant

Recommendation 13b: Qualification of advisors

Do you agree that recommendation 13b is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

Recommendation 13c: Non-professional qualified investor category

Do you agree that recommendation 13c is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

Recommendation 13d: Disclosure

Do you agree that recommendation 13d is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

Recommendation 13e: Investment product databases and comparison tools

Do you agree that recommendation 13e is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

If you disagree with all or part of recommendation 13, how would you amend it?

Re. **banning inducements**, to beware banning underwriter remuneration in the context of bond offerings (as otherwise borrowers would be mostly unable to access capital markets funding) – see [ICMA 15 May response](#) to Commission MiFID/R CP (Qs.49.1/50.1). ICMA agrees with the **financial advisor certification** suggestion.

ICMA supports increasing flexibility in **opting up to professional investor status** rather than a new 'qualified investor' category – see 15 May response (Q.42.1).

Indeed MiFID II should **not hinder** investors from directly accessing non-complex products (bearing in mind that bonds can be technically complex without impacting investor return expectations) – see 15 May response (Q.46/47 on product governance scope).

Re. **disclosure**, PRIIPs KID scope and purpose (not just content) must be reviewed (see [ICMA 13 Jan response](#) to ESMA). Indeed and generally, consumers do not reportedly engage with disclosure. But PRIIPs' failure to deliver efficient disclosure seems due to (i) its overambitious nature (trying to compare cars with lorries, not just cars with cars) as well as (ii) current financial literacy limitations. It may be better to think of preliminary 'basic' disclosure for consumers to create a shortlist of possible investments to consider further – either, for many, with an adviser (human or robotic depending on choice and product type) or, for a few, by being able and willing to engage with the 'full' disclosure (prospectus).

The risk of comparing cars with lorries applies to calibrating **digital comparison tools**, which indeed should be independent – they should not add civil liability risk or administrative burdens on borrowers seeking capital markets funding (see 15 May response, Q.37.1).

Recommendation 15: Withholding tax

Do you agree that recommendation 15 is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important**
- 5 - Very important
- Don't know / no opinion / not relevant

If you disagree with all or part of recommendation 15, how would you amend it?

The absence (not refunds) of **withholding tax** at source (meaning in the hands of a borrower or its agents) has been the basis for the cross-border Eurobond markets for decades. See further *Appendix A17 - Withholding tax* in the [ICMA Primary Market Handbook](#) that ICMA would be happy to share with European Commission staff on request (circa 2,700 characters).

Recommendation 16: Insolvency

Recommendation 16 [Legislative proposal for minimum harmonisation]

Do you agree that recommendation 16a is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important**
- 5 - Very important
- Don't know / no opinion / not relevant

If you disagree with all or part of recommendation 16, how would you amend it?

Harmonised, robust **insolvency laws** are a more direct concern in the high yield bond space (given focus on 'loss given default') than in the investment grade bond space (given focus mainly on 'probability of default').

Recommendation 17: Supervision

Recommendation 17a: ESMA

Do you agree that recommendation 17a is important?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral**
- 4 - Rather important
- 5 - Very important
- Don't know / no opinion / not relevant

If you disagree with all or part of recommendation 17, how would you amend it?

Though **direct/ESMA supervision** may indeed bring some advantages, a significant consideration, at least in terms of bond prospectus approvals, is the potential loss of human expertise (and related predictability) built up over decades in various national regulators around specific types of bond issuance. This could cause significant/disproportionate disruption to borrowers seeking to access European capital market funding. See further [ICMA Dec 2017 response](#) to Commission Omnibus III CP. However, the proposal (at p.118 of the CMU HLF Report) that the ESAs be given the power to issue **no-action (waiver) letters** is welcome (see #118 of [ICMA April 2015 response](#) to Commission green paper on building CMU).

Recommendation 18: European consolidated tape (ECT)

The HLF decided not to table a recommendation on a European Consolidated Tape. Do you consider that the creation of a European Consolidated Tape is important to the Capital Markets Union?

- 1 - Not important at all
- 2 - Rather not important
- 3 - Neutral
- 4 - Rather important
- 5 - Very important**
- Don't know / no opinion / not relevant

Could you please explain your response on the importance of the ECT?

ICMA's response solely relates to cash bond markets

ICMA is surprised the HLF has decided not to recommend a European consolidated tape, unless the purpose of not tabling a recommendation is to allow the Commission, through the medium of MiFID II/R, to take forward consolidated tape initiatives for both bond and equity markets. If this is the case, ICMA is supportive of MiFID II level one changes in order to create an EU bond consolidated tape.

There is consensus agreement amongst ICMA members, a trustworthy, affordable and centralised EU bond consolidated tape would not only improve transparency but also assist decision-making and provide market insights to end-investors, large or small, professional or retail. Adoption of the appropriate centralised post-trade market structure (which is currently fragmented across the different APAs and trading venues) would enhance investor confidence. Resulting in the creation of stronger and more liquid EU capital markets, promoting capital formation, job creation, and economic growth. All goals of the CMU.

More specifically, with a fully functioning post-trade bond consolidated tape, benefiting from good quality data, reliable liquidity assessment and appropriate transparency regime, market participants would have the confidence to successfully use post-trade bond data for pre-trade price discovery. During recent Covid-19 stressed market conditions, ICMA trading market participants found a fully functioning post-trade bond consolidated tape would have assisted decision making. With timely post-trade bond data, investors would have had the confidence to know the prices they were seeing were not stale prices. Furthermore, bond algorithms which rely on post-trade bond data may not have broken down, as witnessed in Covid-19 markets. Lastly, ICMA members believe a trustworthy post-trade bond consolidated tape would have helped risk managers during Covid-19 analyse bond markets, potentially mitigating or transferring risks.

For more information on a bond consolidated tape in EU bond markets please see [ICMA's April 2020 CT report](#).