BlackRock

Putting the capital
in the European Capital Markets Union

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Executive Summary

BlackRock remains strongly supportive of the Capital Markets Union (CMU). Building deeper, better-connected capital markets in Europe is an important objective to promote investment, realise the goal of a true Single Market for capital, and help European savers and companies realise their long-term financial objectives.

To date, the CMU has built a policy agenda that, when seen through to completion, will provide a framework for advancing this aim. But important challenges remain, and some of the remaining barriers will be difficult to break down, both technically and politically. We see the most valuable way to add greater imperative to addressing these challenges is to refresh the CMU agenda so that it can deliver something meaningful and tangible for European citizens: improved ability to save more effectively in the long-term and to better connect to broader economic prosperity.

The result will be mutually beneficial to European citizens, companies and policymakers. A more engaged investor base not only represents a growing supply of capital for companies to tap for investment, but equally advances a number of key policy aims: reinforcing the Banking Union and European Monetary Union, underpinning the role of the euro globally, and meeting the European Union's (EU's) ambitious sustainable investment goals.

In this *ViewPoint*, we set out a vision for a recast of the CMU that breaks down across three pillars:

- **Pillar One:** A meaningful policy vision to balance investor protection and investor inclusion with a focus on enabling greater retail investor participation
- **Pillar Two**: Bedding down an investor-friendly capital markets architecture that lets European investors benefit from the combined scale of European and global markets
- **Pillar Three**: A clearer vision for capital-raising across Europe, based on further work with companies to meet their funding needs

Summary of recommendations

Promote retail investor participation

1. Simplify the investment process
2. Harness the power of digital tools to engage with consumers
3. Allow regulation and supervision to follow the move away from selling individual products to providing multi-product solutions
4. Focus on value for money across the entire chain of distribution with meaningful comparability and transparency of products, advice, and distribution
5. Encourage Member State initiatives to drive increased investment; such as auto-enrolment

Optimise the capital markets architecture to maximise investor utility

6. Address market fragmentation to deliver for end-investors
7. Underpin investor confidence in central clearing

A company-oriented vision for capital raising in Europe

8. Re-imagine the funding escalator
9. Optimise the ELTIF structure and tax framework for investors to better deploy capital

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Introduction

The CMU was first articulated by the Juncker Commission in 2014. Its goal was to promote the growth of market-based finance as a complement to bank funding in Europe, and to better connect national capital markets in Europe. The EU's Single Market would deliver a scale and efficiency benefit, creating investment opportunities for Europe's savers, and providing more capital to Europe's companies.

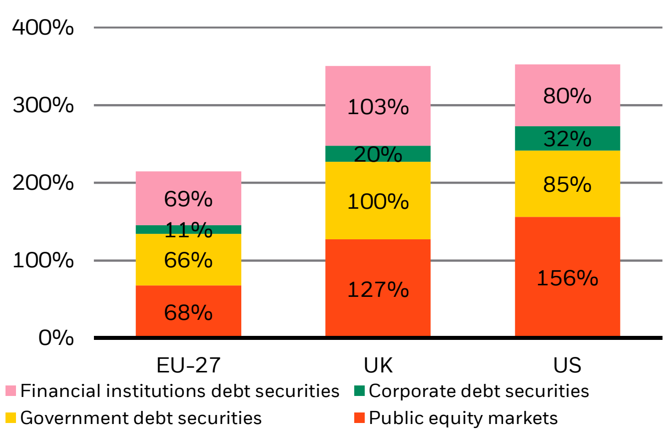
The European Commission's 2015 CMU Action Plan[1] set ambitious legislative objectives and, importantly, changed the tone of the political conversation about capital markets from one of post-crisis remediation and reform to one of promoting market-led economic growth.

Developing liquid and integrated European capital markets remains a work in progress and should continue to be at the top of the European Commission's agenda during the 2019-2024 legislative mandate. Indeed, the prize for delivering on the objectives of the CMU remains great.

Despite progress made to date in growing forms of market-based finance in Europe[2], the financing that capital markets can provide as a complement to well-developed bank funding channels in Europe remains a significant source of as-yet untapped potential (Exhibit A).

Exhibit A: Bank lending vs. corporate bonds

Structure of capital markets (end-2017, % GDP)



Source: 2018 ECMI Statistical Package and the Lannoo, K. and A. Thomadakis (2019), "Rebranding Capital Markets Union: A Market Finance Action Plan", CEPS-ECMI Task Force Report, Centre for European Policy Studies

Fulfilling the goals of the CMU is as necessary today as it was when the project was first conceived. The direct benefits of further building up the CMU are only part of picture. There are a number of areas where progress in the CMU would be highly complementary to other EU strategic priorities. For example:

- **European Banking Union** – a critical goal of the Banking Union is to increase the resiliency of the banking sector. Vibrant capital markets can provide a meaningful risk transfer mechanism away from the banking sector, and can directly support banks' lending and finance provision capacity.
- **Economic and Monetary Union** – deeper European capital markets can create an effective cross-border private sector risk sharing mechanism that can help lower the need for sovereign-level risk sharing in times of economic stress.
- **Enhancing the international role of the euro** – deeper European capital markets which remain open and attractive to global investment and where EU investors can seek global investment opportunities will increase the internationalisation of the euro.
- **Growing and promoting sustainable finance** – the principal aim of the EU Action Plan on Sustainable Finance is to mobilise capital to support sustainable investment.[3] A central premise of this agenda is the increasing interest of average retail savers in putting their capital to work towards advancing sustainability goals. Growing European capital markets through increased investment (especially retail investment) is critical to achieving the aims of the EU Sustainable finance agenda.
- **Stimulating growth and economic resilience** – continued progress on further diversifying funding channels will enhance the overall systemic resilience of the European economy.

A clear re-articulation of the CMU goals and agenda is needed to create the political imperative to take the necessary steps at both European and national levels. A number of EU legislative files in implementation or under review in the coming legislative term serve as important building blocks for CMU; delivering and further optimising these will materially advance the aims of the CMU.

In addition to the EU legislative agenda, the full benefits of the CMU will ultimately depend on action taken by the Member States in areas such as taxation, pensions and financial education policy, where they generally have the right of initiative and competence.

This re-articulation of the CMU goals and agenda must answer not just what the CMU means to the EU project, but what the CMU can mean to European citizens.

We continue to believe that an investor centric effort to make European capital markets better connected and more efficient will yield great economic benefits for investors and companies alike.

An investor friendly capital markets architecture that, for example, gives investors transparency of trading activity across all European venues, strengthens the integration and competitiveness of European markets, increasing long term savings for European citizens and lowering the cost of capital for European companies. Similarly, a clear framework that protects end investors from bearing undue losses due to the failure of Central Counterparties (CCPs) is essential for investor confidence and a durable CMU: investor participation in central clearing is the backbone of systemic resiliency.

However, the area of the original CMU agenda that has probably been the least developed is the one where we still believe the greatest dividend for Europe is to be found: a meaningful approach to incentivising savers to invest in capital markets that both brings more capital into European markets and psychologically more important, delivers long term economic benefits to Europe's citizens as they plan for their futures.

The focus of the next five years must be to make meaningful progress in incentivising citizens to use capital markets as a way of meeting their goals of long term financial security.

Defining 'investor'

In this *ViewPoint*, we make the case that the CMU should be seen as a vehicle to better engage European investors, and that the policy agenda should seek to build an investor-centric framework that balances investor protection and investor inclusion, and protects investor capital throughout the system. It is useful to be precise about what we mean by 'investor':

- **Asset owners** can manage their money directly and/or outsource this function to asset managers. Asset owners include individuals, pension funds, insurers, sovereign wealth funds, foundations, endowments and family offices. In this *ViewPoint*, we refer to asset owners also as 'savers', 'investors', 'end-investors' or 'consumers' (when referring specifically to retail investors as they consume investment products and services).
- **Asset managers** act as agent on behalf of their clients, the asset owner. Asset managers are required to act as a fiduciary and invest according to the investment guidelines set out in the legal documentation of the mandate, or the product selected by the asset owner. When looking at wholesale markets issues and how capital moves through the plumbing of the financial system, it is often the asset-owners' agent – the asset manager – to whom the concept of 'investor protection' is applied.

Pillar One: Promote retail investor participation

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Head of
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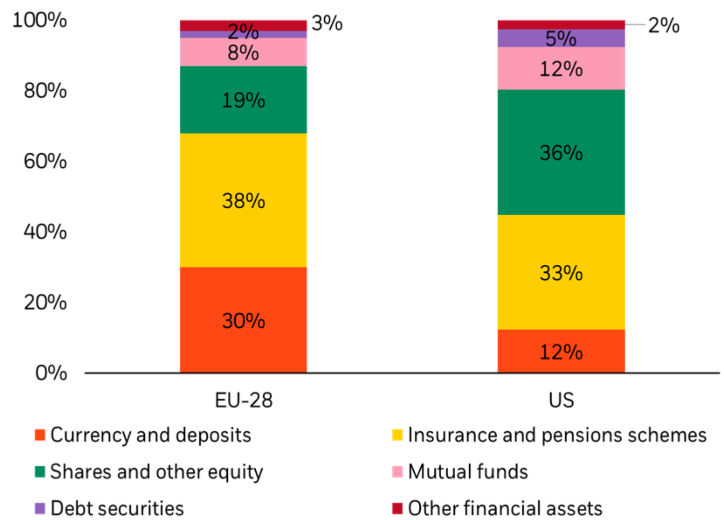
Retail business

The CMU's goal of encouraging deep and robust capital markets across Europe requires significant retail investor participation to become a reality. It follows that a renewed focus on creating a framework to support increased retail participation in capital markets should be at the centre of the European Commission's mission statement on driving the CMU forward.

Exhibit B shows a significant reliance on cash savings across Europe, cash and bank deposits amount to 30% of total EU-28 household assets, compared to 12% in the US. Investors require cash for a variety of reasons, but, in the long term, European investors would benefit from diversifying their savings among different asset classes.

Exhibit B: Financial assets of households in EU-28 and the US

(end-2017, % of total financial assets)



Source: CEPS Rebranding Capital Markets Union: A market finance action plan, Eurostat and OECD

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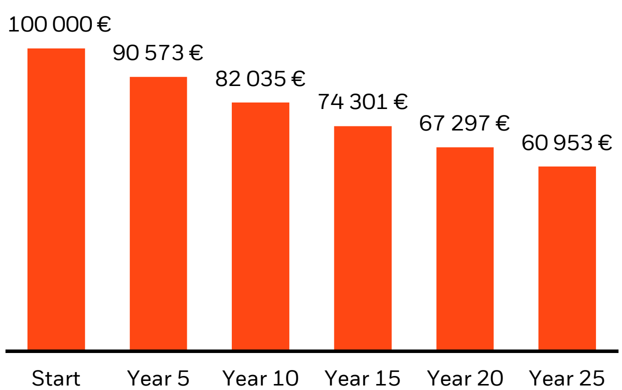
As an abiding principle underpinning the CMU, we believe that investor-centric regulation is crucial to give investors of all kinds the confidence to commit capital to markets

The persistent low interest rate environment in Europe adds pressure on long-term savings. Relatively more US households have exposure to capital markets (Exhibit B) and so have experienced the wealth generating effect of unconventional monetary policy. In contrast, these wealth-building effects have been restricted to too few European households. European citizens are overly-reliant on significant cash savings and so are more exposed to the long-term negative effect of inflation on their wealth. Exhibit C shows the significant impact inflation has on the purchasing power of cash savings over time. With fairly modest inflation almost a tenth of purchasing power is lost over five years and around 40% over a 25-year period.

Achieving stronger participation of retail investors in European capital markets is fundamental to CMU's objective of turning more savings into productive investment, and so building up stable long-term pools of private capital. These pools of capital investment can enable consumers to participate in the growth of European companies and build up the long-term retirement

Exhibit C: The effect of inflation on the real value of cash savings

Purchasing power in €



Notes: Assuming constant inflation of 2% on an annual basis and no interest income.
Source: BlackRock. For illustrative purposes only.

savings pots consumers are increasingly going to need to supplement retirement income from state-sponsored or corporate pension schemes. Developing deep pools of stable capital to support long-term investment will have the double benefit of providing equity to finance innovation and supporting the continued growth of sustainable finance.

We need, however, to recognise that the primary driver for mass retail investors is not to buy a financial product or service, but to achieve one of their many life goals (additional income to support retirement lifestyle, house purchase, fund children's education etc.). Financial products and services are simply a means of achieving these goals. And achieving these life goals normally requires investing in a combination of products and services, for example by investing in a diversified portfolio of investments with regular rebalancing of risk over time, rather than in any single investment product**.**

Europe needs therefore a strong policy vision and coherent narrative to drive forward the democratisation of investment in Europe, **and to overcome the fragmentation of product and service regimes impacting the retail investor.**

The various products and services offered to European investors came into being through a patchwork of EU directives and regulations. This patchwork has resulted in a number of significant inconsistencies and gaps. In addition, the policy focus is channelled into siloed and technical debate on individual pieces of legislation, each with its own political dynamics and influences, diverting political attention away from the core purpose of stimulating greater retail investment in markets. The combined effect is a confusing web of incongruent disclosures and red tape that do not empower the European citizen to invest in their family's financial future.

In our annual Global Investor Pulse survey, we look at barriers to investing for European citizens. While some respondents do indeed show great risk-aversion and cite being afraid of losing money as a barrier to investing their savings, far more people cite barriers like access and lack of understandable information.[5] Building off this, we propose five sets of policy principles to make it easier to invest in markets and empower citizens to achieve their long-term savings goals while maintaining enhanced levels of consumer protection.

Many consumer protection-related rules are due for review in the course of the upcoming European Commission. Before embarking on piecemeal amendments we recommend the European Commission agree a core set of principles to drive effective consumer engagement and to facilitate the use of digital delivery tools, which can act as a benchmark for changes across different pieces of legislation.

1. Simplify the investment process

The European Commission should start by looking at consumer financial services legislation **holistically, seeking to answer the question: 'how can legislation support savers in meeting their lifetime goals and simplify the process of investing?'** The bulk of EU legislation looks at the concept of investor protection in a silo – that is, relative to a specific product or service – rather than forming a comprehensive framework across all savings channels and products balancing investor protection and investor inclusion.

> **"If you want to get people to do something, make it easy. Remove the obstacles.**
>
> Richard Thaler, Nudge[5]

The first step should be to revisit the framework for product intermediation and financial advice, reducing the number of distinct steps consumers have to take to invest; for example, looking to minimise the need for repeated know your client and take on procedures which add additional cost and time to the take on process and disincentivise consumers from beginning to save and invest. We recommend developing a single portable fact find.

The next step should be to minimise the multiple overlapping documents and disclosures to consumers and the inconsistencies in service delivery that exist today across the different legislative and regulatory pieces: Markets in Financial Instruments Directive (MiFID), Packaged Retail Investment and Insurance-Based Products (PRIIPs), Insurance Distribution Directive (IDD), Undertakings Collective Investment in Transferable Securities (UCITS) and the forthcoming package of sustainability disclosures.

Most retail investors increasingly use a combination of products and services – and disclosure regimes should reflect this. We recommend increased use of disclosures aggregated by the end service provider (e.g. advisor or distributor). This means bringing different products and services together as a single combined disclosure, simplifying and aligning multiple individual disclosures. This would greatly streamline the consumer experience, avoiding today's situation where too often consumers experience separate product and investment service disclosures.

The cumulative effect of existing disclosure documentation across entire investment portfolios can run to dozens or even hundreds of pages for some investors. These are unlikely to be read in any detail by retail consumers. Where intermediaries offer clients multi-product solutions we recommend increased focus on the development of best practice in delivering aggregated statements of performance, risk and cost at the level of the portfolio - to provide a safe harbour for distributors looking to simplify disclosure to their investors.

In the absence of a single horizontal consumer protection text, we recommend delivering this through a purposeful review of existing legislation with common benchmarks of what constitute effective consumer engagement. Whenever possible, we recommend avoiding embedding inflexible, detailed standards in Level 1 and encourage standard-setting at Level 2 and 3 which allow inconsistencies to be remedied more easily.

2. Harness the power of digital tools to engage with consumers

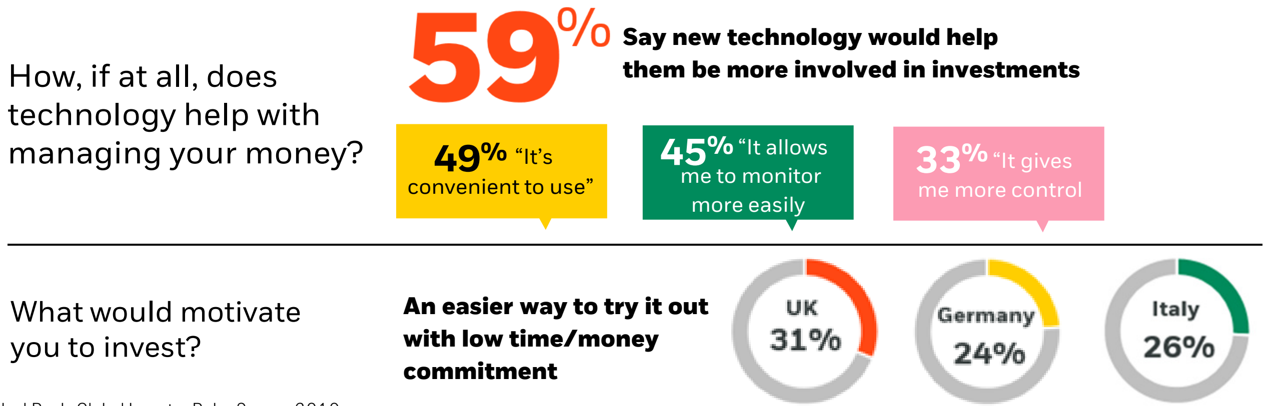
A comprehensive policy approach must reflect the way consumers access information and invest both today and in the future: digital technologies are creating **smart and engaging ways of enhancing the consumer experience and facilitating investment.**

Digital distribution can dramatically increase retail clients' engagement (as shown in Exhibit D), often through improving the visualisation of investment services and advice. Digital and technological progress are leading to fundamental changes in how people buy investment products and services and their perception of value.

Addressing consumer confidence is key when implementing new consumer-facing technologies, and robust cyber security protections are paramount to the success of any digital service. As with any internet-based technological service provider, digital distributors should view cybersecurity as a critical component to the provision of their services, which includes safeguarding client sensitive data and personally identifiable information (for more recommendations see reference to our Digital Investment Advice *ViewPoint* on page 16).

We would encourage the use of digital take on procedures, know your client and portable suitability profiles as key tools to achieve greater simplification of the administrative burden of investment, and would recommend that any reforms allow for, if not explicitly build in, these tools.

Exhibit D: Tech solutions have a role to play to encourage trial by European citizens



Source: BlackRock, Global Investor Pulse Survey, 2019

Open Banking and the changes in the payment services market as a result of the Payment Services Directive (PSD2) are instructive in their impact on consumer engagement and innovation. **Three deliverables are key to simultaneously giving consumers greater control of their finances, and taking duplicative costs out of the investment process:**

- We see the first step as the creation of a unique financial **'digital identity'** for every consumer. Building on the developments coming out of PSD2 which has been a catalyst by allowing consumers to be identified through open banking protocols, and so cutting out the administrative burden in the payments space. As a second step the EU can facilitate the creation of a common identification standard meeting robust levels of digital security which works across borders which would be workable when applied to investing.
- Develop a **personalised and portable fact find**, with financial goals and targets, which the consumer controls. While there has been much work done on developing portable consumer preferences in wider consumer services, especially in the area of payments (e.g. see EU's Blockchain and Digital Identity Report which sets out a number of recommendations[6]), we have seen relatively little policy discussion of how these technologies could drive greater end-investor engagement. Technology such as digital wallets can facilitate the use of portable fact finds which have the potential to reduce much of the existing repetition and paper based systems in the investment market.
- While digital services are developing apace, much of the legislative framework has been conceived on the basis of face to face communication and paper-based disclosures, with digital delivery treated as an add on rather than the primary source of communication. **The regulatory framework for investment products and services must adapt to allow for innovation and recognise the changes digital services bring.**

Rather than deluge consumers with reams of paper and disclosures, **disclosures should leverage more intuitive digital tools to increase point of sale engagement and education on key concepts such as cost, performance, and risk.** Paper-based disclosures (even if pdf) should be seen as a legal record of the consumer's final decision rather than acting as a static document they must get through at the start of their decision-making process. The scheduled review of legislation should avoid creating barriers and incentivise effective digital engagement – at the very least we need to recognise that a pdf of a paper document does not constitute effective digital engagement.

We believe that much can be achieved quickly through the publication of best practices and guidelines by the European Supervisory Authorities (ESAs) to provide greater certainty of compliance. This approach will avoid a fundamental rewrite of the existing disclosure.

3. Allow regulation and supervision to follow the move away from selling products to providing multi-product solutions

The implementation of MiFID II across the EU, and the increasing national-level bans or restrictions on commission payments at EU level are leading to **a fundamental change in the way investments are provided to end-investors: a shift away from products towards broader portfolio- and outcome-based solutions.** This means that, increasingly, advisors and distributors are offering packaged solutions, rather than recommending individual stocks or funds.

Technological developments are increasingly allowing advisers to aggregate risk across a range of products, and build more efficient investment portfolios that better reflect investors' needs, preferences and risk tolerances while providing investors greater transparency on investment outcomes. For example, the development of default glidepath investment solutions[7], as used in many robo-advice offerings, incorporates suitability assessments at the product level, while allowing end-investors to see how their portfolios are likely to rebalance over time to meet their long term goals.

We see initiatives such as European Insurance and Occupational Pensions Authority's (EIOPA's) Guidelines on risk mitigation strategies for the PEPP[8] as a precedent for developing European standards. Outside the EU these strategies have an established track record in providing retirement solutions. A European designated standard for lifecycling strategies as part of EIOPA's work on implementing PEPP will incentivize adoption of lifecycling both at the EU level in PEPP and at Member State level by national schemes.

We recommend continued supervisory engagement by the European Securities and Markets Authority (ESMA) and National Competent Authorities (NCAs) setting out examples of best practice in providing aggregated and digital solutions which drive greater consumer engagement.

Standards on suitability must evolve to recognise the importance of portfolio outcomes, rather than individual product outcomes, allowing a variety of products to be included which meet an individual's long-term risk appetite as well as providing inflation protection. We believe the portfolio level assessment would be the right approach to take in the context of the current discussion on the integration of ESG preferences into existing suitability guidelines under MiFID II and IDD.[9]

4. Focus on value for money across the entire chain of distribution with meaningful comparability and transparency of products, advice, and distribution

End-investors engage with a broad range of financial advice and intermediation which helps them meet specific financial needs. The legislative and regulatory framework, in contrast, often conceptualises this narrowly as the sale of individual investment products. A policy framework that engages, includes and protects Europe's end-investors must **consider 'value for money' across the entire chain of distribution: that is, not only the costs of individual products, but the value delivered by ongoing advice and other distribution services**.

Investor protection measures are product-specific, whereas end-investors are largely agnostic about what type of investment product they buy, and focus on how to achieve the outcome they are aiming for. Retail investors in particular place significant emphasis on trust in the intermediary (including brand reputation), the quality and trustworthiness of the advice they receive, and overall value for money.

Cost is, of course, a key – though not exclusive – aspect of value for money, but product costs need to be read together with other key drivers of value such as performance, risk, and quality of service.

The European Commission is conducting feasibility studies on a cost calculator to facilitate consumer engagement**. A tool like this will have the most meaningful impact for end-investors if it allows consumers to compare the costs of services (such as advice or portfolio management) as well as product costs.** Only then can investors understand the aggregate costs of their savings solution and the value they receive across all service providers delivering that solution. Without a holistic approach the cost calculator is likely to remain a tool for intermediaries looking for comparable product data when constructing portfolio solutions for their clients.

An approach covering products and services would support the ESAs objectives to deliver better data on the value of the component parts of retail financial services by aggregated product and distribution or advisory costs.

5. Encourage Member State initiatives to drive increased investment; such as auto-enrolment

The first phase of the CMU delivered an important framework for advancing long-term savings provision, the PEPP. Yet, the upcoming Level 2 measures will be crucial in supporting the successful launch of the PEPP and determining its attractiveness to providers and investors.

Alongside the achievements of recent years (such as the European Long-Term Investment Fund (ELTIF), and national initiatives) there are a variety of other meaningful tools which can help grow the pool of long-term capital in Europe. But these tools must be put to better use.

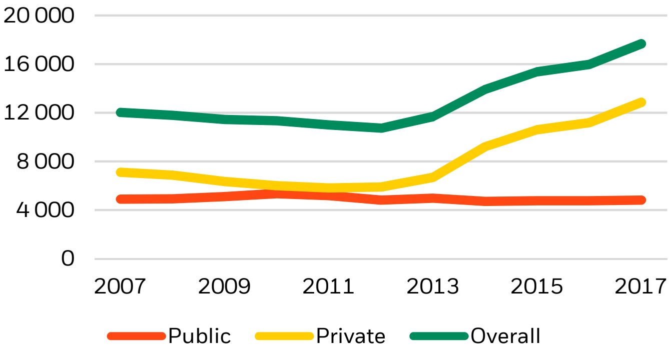
The original CMU programme put significant emphasis on encouraging Member States to effect change in areas such as insolvency with the Commission taking an intellectual lead, developing best practices, and benchmarking national efforts. We believe the Commission could take a similar approach to retail financial services.

Financial education of consumers is a critical issue but is likely to be a multi-generational project. In terms of delivering faster results in the meantime we see a number of ways of working with Member States to encourage the allocation of savings into European capital markets.

The EU could for example work with Member States to harness the power of auto-enrolment[10] to crowd savers into capital markets using diversified, risk-managed portfolios such as those being put in place under the PEPP. This could lead to many millions of European savers investing in markets over a relatively short time frame. As shown in Exhibit E, the implementation of auto-enrolment in the UK in 2012 contributed to a dramatic uptick in pensions savings, and increasing investment in capital markets.

Exhibit E: Number of eligible employees participating in workplace pension participation in the UK

2007-2017 (thousands)



Figures for number of employees are for indicative purposes only and should not be considered an accurate estimate of employee job counts.
Source: DWP estimates derived from the ONS ASHE, GB, 2007 to 2017.

Pillar Two: Optimise the capital markets architecture to maximise investor utility

Daniel Mayston

Head of BlackRock's Market Structure and Electronic Trading, EMEA

The global capital market ecosystem relies on a combination of market infrastructure, market practices and legal systems. A key aim of the CMU has been to improve the functioning and efficiency of this market architecture within the EU, while strengthening cross-border integration and interconnection among Europe's capital market infrastructures. There are still notable gaps in the framework, meaning this remains an important aim in the context of CMU. **Reinforcing the protection of end-investors participating in capital markets will improve investor confidence, thus enhancing the prospects for CMU.**

The first phase of the CMU saw the implementation of key market structure rules (e.g. MiFID II, Markets in Financial Instruments Regulation (MiFIR), European Market Infrastructure Regulation (EMIR) review), done through the lens of supporting the broader policy aims of the CMU. But equally importantly, there was an effort to clearly identify barriers to a more unified approach to post-trading across EU countries, and to set out an agenda to make European corporate bond markets more efficient.[11] The work carried out by the respective European Commission expert groups under the last mandate was authoritative.

These associated work plans (for example on corporate bond market liquidity) represent strong starting points for continued improvements to cross-border European capital markets and should, as such, be taken forward under the new European Commission.

Going forward, the concept of investor protection should extend beyond the product intermediation process, to be applied to the framework for how investor capital is channelled through markets. **Today in Europe, once investor capital is invested in markets, it is generally channelled through market infrastructure that provides sub-optimal efficiency and protection for investors and their agents.** An integral part of any reflection on the future of CMU, therefore, should be a consideration of the efficiency, safeguards, and costs of utilising European capital markets architecture.

There are additional reforms – entirely within the existing powers of already-agreed legal frameworks or current legislative discussions – that would make a meaningful difference for end-investors in terms of efficiency and confidence gains.

One key area is transparency. MiFID II was intended to be a wide-ranging reform of market structure – covering everything from trading execution rules to price transparency and market data – and it has indeed had wide-ranging consequences for European markets. Since it has come into effect in January 2018, there have, from an investor perspective, been several notable improvements regarding the volume and breadth of data reported, but there is still some way to go to turn this data into useful information for investors and regulators alike.

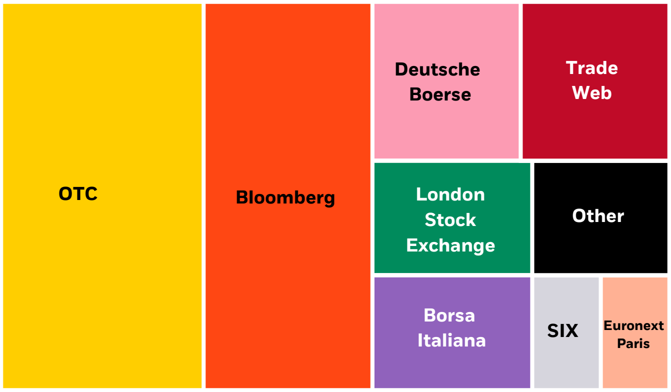
Another area is ensuring that the shift away from bilateral Over The Counter (OTC) markets towards central clearing where it is viable (such as for certain derivatives, Exchange Traded Funds (ETFs), repo and securities lending transactions), is done in a way that protects the interest of investors participating in the system to the greatest extent possible. Completing this agenda, with investor access and protections at its centre, would reinforce investor confidence in Europe's capital markets and with it, help to lay the foundations of a durable CMU framework.

6. Address market fragmentation to deliver for end-investors

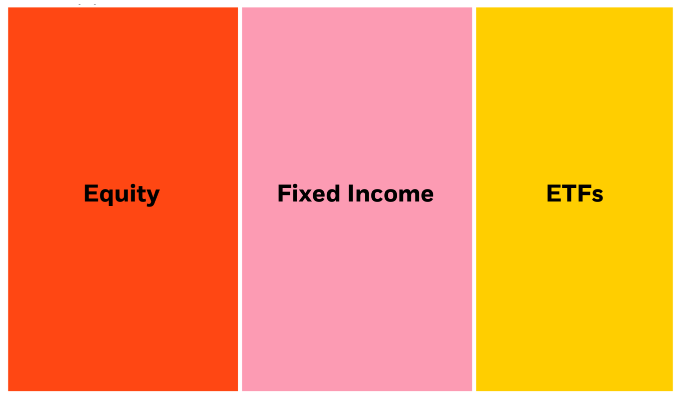
MiFID I set out to increase competition within investment services in Europe. When it took effect in November 2007, it helped to support the rise of alternative trading venues, most commonly referred to as Multilateral Trading Facilities (MTFs). As a result, the liquidity of a given stock was no longer concentrated on one exchange.

Exhibit F: Comparing the current situation of European ETF trading volume (by venue type) to the aspiration of a pan-European consolidated tape

Current situation: Fragmented picture of ETF trading volume by venue type



Aspirational situation: Data consolidated into a single feed **per asset class** for all investors in European



Source: Bloomberg, BlackRock as of end 2018. For illustrative purposes only.

As a result, liquidity became spread across a growing number of trade-execution venues, increasing competition for orders between these various pools of liquidity, but also, causing liquidity pools in Europe to become fragmented.

Under MiFID II, a consolidated tape was proposed to address this fragmentation, itself a by-product of increased competition amongst trading venues. BlackRock argued at the time that a pan-European consolidated tape would clearly benefit Europe's end-investors by providing retail and institutional investors alike with a single authoritative price at which stocks trade in Europe. It would also potentially benefit European issuers by lowering the cost of capital and represent a meaningful step towards completing the Single Market in financial services.

Despite the alignment of these objectives with the CMU, a consolidated tape has not come forward, although a framework was established under MiFID II by which one could do so. As a result, investors in European assets today remain disadvantaged compared to other developed markets, **since it is still difficult to answer two simple questions in relation to European equity trading: what is the price of a stock? And how many shares have been traded?** The situation is replicated in other securities and investment vehicles such as bonds and ETFs. As shown in Exhibit F, the complexity of understanding the price and liquidity of a typical European domiciled ETF remains after the introduction MiFID II.

A consolidated tape would educate more retail investors about the best trade prices and quotes which occurred in the market and creates competitive pressures so that retail investors cannot be disadvantaged (similar to a price comparison website). This will increase in importance as the use of online investment tools grows. A tape would also help both institutional investors and retail investors who trade via brokers to improve their trading process and best execution by giving them immediate insight into trading activity, liquidity, and prices.

In the context of the CMU, a consolidated tape creates transparency of trading activity across all European venues and equips all investors with the necessary price and liquidity data to decide which venue is the most beneficial. This strengthens the integration of markets and its competitiveness by enabling investors to trade cost-efficiently.

A consolidated tape is long overdue in Europe. The partial solution in MiFID II – providing a pathway for a commercial provider to emerge – has failed to deliver a much needed market utility, and its continued absence only prolongs and intensifies intra-EU market fragmentation. It is time to address this market failure in the context of CMU by delivering a single and authoritative tape of post-trade information relating to covering European equity, ETFs, and fixed income products, with relevant data standardisation and its governance overseen by ESMA.[12]

7. Underpin investor confidence in central clearing

The re-articulation of the goals of the CMU represents an opportunity to review and refresh the framework that underpins investor confidence, since investor confidence reinforces systemic stability and with it the viability of the CMU project. The focus on reforming a largely-OTC market for derivatives by increasing the percentage of bilateral derivatives trades into a centrally cleared framework was a core pillar of the global post-financial crisis regulatory response to strengthen systemic stability. The result of this has been a significant market shift from bilateral to cleared derivatives. It is therefore important to think through how the end-investor is protected when they decide to clear voluntarily (e.g. clearing trades not subject to a mandate) or are indeed required to clear by legislative mandate in Europe.

BlackRock is supportive of central clearing. The reduction in bilateral counterparty credit risk, increased market transparency, together with the improved efficiency in trade execution outweigh the significant operational costs incurred by market participants and end-investors to comply with clearing mandates. In fact, several market participants who are not subject to clearing mandates, including end-investors, do decide to clear voluntarily. This indicates that clearing mandates may not always be necessary and that these firms see advantages in clearing.

While central clearing of OTC derivatives as a concept (and the market practice around it) matures, the framework to incentivise clearing through resilient CCPs, that protect the interests of all stakeholders in times of stress, is still a work in progress.

Those market participants clearing voluntarily may reassess their options unless the market and regulators address certain shortcomings and provide more clear investor protections in the clearing system. Indeed, the September 2018 loss event incurred in the Nordic power markets[13] revealed that CCPs are not immune to market disruptions and that a regulatory focus needs to be maintained on enhancing CCP resilience, recovery, and resolution measures. **Investor confidence should be in no way taken for granted.**

When it comes to setting a clear objective for completing EU clearing reforms, we believe there should be three goals that should be at the heart of the ongoing negotiation of EU legislation on central clearing:

- Increasing participation in clearing
- Enhancing CCP and ecosystem resiliency
- Protecting the end-investor in the CCP recovery and resolution framework

These objectives should be shared by both policymakers and market participants – each of whom will play an important role in realising the vision.

Increasing participation in clearing

Bringing a greater number of OTC participants into clearing on a voluntary basis increases the overall viability of clearing in a given asset class, as it decreases cost and increases systemic resiliency. However, to appeal to a wider group of market participants, challenges need to be solved and clearing models must evolve to reflect wider segments of market participants.

In our view, policymakers should renew their focus on cross-border equivalency for CCPs and consider granting equivalency for clearing members. **A view on regulatory equivalency between CCPs and clearing members is required. Different legal requirements between jurisdictions create a high bar for end-users to access clearing services on a global basis.** A globally coherent regulatory framework for clearing is particularly important given the global nature of the derivatives market.

Industry stakeholders have an equally important role to play. In particular:

- CCPs should offer increased opportunities for netting offsets. These could incentivise clients to clear more positions voluntarily through the CCP. Such offerings should be carefully constructed and regulated to avoid a race to the bottom in risk management.
- Pension funds should be able to post high quality liquid securities as variation margin to the CCP. This would be an industry-led solution that could, over time, remove the need for the EMIR pension fund exemption in the EU and bring additional participants into clearing.
- Market participants can improve coordination and address inconsistencies. Private sector stakeholders should better co-ordinate participation across end-users, clearing members and CCPs when launching new products. Addressing inconsistencies around the costs of clearing (which ultimately are borne directly or indirectly by the end-investor) could help to facilitate broader participation.

Enhancing CCP and CMU resiliency by protecting the end-investor in clearing

Key to reinforcing end-investor confidence in clearing, will be the strengthening of CCP resiliency. Measures to ensure resiliency are an important buffer to avoid recovery and resolution situations and should be a key focus for co-legislators in finalising negotiations on the CCP Recovery & Resolution Regulation. A number of technical recommendations to enhance CCP resiliency are set out on page 11.

Technical recommendations to protect the end-investor in clearing

To improve CCP resiliency, the following recommendations would, in aggregate, improve CCP and overall systemic resiliency:

- Strong CCP governance: enhancing governance practices to obtain and address input from a broader array of market participants on relevant risk issues.
- Disclosure and transparency: publication of meaningful, standardised, and audited disclosures on CCP risk methodologies, back testing, and stress testing.
- Robust and stable initial margin: incorporation of liquidity and concentration factors into initial margin calculations and application of appropriate margin periods of risk.
- Conservative default fund sizing: sizing the default fund to a minimum "Cover 2" standard, using extreme but plausible scenarios.
- Material Skin In The Game (SITG): enhanced CCP contributions to financial safeguards through meaningful "SITG" - 20% of default fund.
- Effective and credible default management processes.
- Product Suitability: limiting clearing to liquid products for which there is adequate market capacity.
- Limited emergency powers: applying rigorous governance and clear limits to emergency powers.
- CCP responsibility for non-default losses, supported by appropriate regulatory capital requirements.

Regarding CCP recovery planning, allocating losses to end-investors through haircutting their margin in a process they often do not choose to enter nor over which they have any control, erodes investor confidence and undermines attempts to build CMU. We therefore propose the following constraints on the use of this tool in a CCP recovery process:

- Variation Margin Gains Haircutting (VMGH) losses should be capped and limited to one round of haircutting. This would allow for appropriate measurement and management of CCP risk exposure.
- VMGH losses incurred by end-investors should mandatorily be shared with clearing members. This would ensure full alignment of interests of stakeholders towards prompt and effective resolution of the CCP.
- Participants subject to VMGH should receive a senior claim against the CCP and its successors for the full amount of the variation margin taken from them. This reflects the way in which a CCP would hold a claim over defaulting participants.

There are an additional number of measures that could facilitate CCP recovery in a smooth and orderly fashion, whilst protecting the end-investor and with it reinforcing the CMU. Specifically, we recommend:

- Pre-defined assessment rights capped at one time each clearing member's Default Fund Contribution (DFC) (1x DFC).
- Voluntary CCP contribution: a second tranche of SITG after clearing member assessments and provisions to allow for additional (voluntary) CCP capital infusions.
- Mandatory poll of clearing members: introducing a clearing member ballot (after the initial 1x DFC assessment) to determine if enough market support is available to allow the CCP to make an additional assessment capped at 1x DFC.
- Resolution or systemic risk authority approval before the CCP uses additional recovery measures, such as VMGH or Partial Tear-Ups (PTUs) on a limited basis.
- Loss compensation: compensating clearing members and end users for losses incurred through post-ballot assessments, VMGH, or partial tear ups, whether during recovery or resolution.

Finally, to enhance resolution, we recommend that resolution and systemic risk authorities:

Require CCPs to set aside ex ante resources (e.g. bail-inable securities) for recapitalization :

- Conduct regular reviews of CCP rulebooks to ensure a common understanding and coordinated approach.
- Form cross-border crisis management groups to develop and test resolution playbooks.
- Work with CCPs to develop clear and credible resolution plans that provide enough transparency to the market.

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Another crucially important element of an investor-centric central clearing framework is protecting the end-investor from bearing undue losses due to the failure of CCPs. In this regard, we reiterate our objection to the use of VMGH by CCPs and request regulators formally limit its application. This should be given due focus as the CCP Recovery & Resolution Regulation is finalised.

We view the haircutting of VMGH as akin to allocating losses. We believe that the authority to use this tool should only be available to public resolution authorities, and entirely removed from CCP rule books.

Without a clear framework for how this would be applied, it could have potential procyclical effects in times of market stress. We set out a number of technical recommendations in relation to protecting the end-investor in a CCP framework (page 11).

Investor participation in central clearing, whether mandated by law or voluntary, is the backbone of the increased systemic resiliency that clearing reforms have helped bring about. End-investors already bear the cost of this enhancement of systemic resiliency so it is essential that investors are protected, or certainly find themselves no worse off than other clearing system participants who gain commercially from their ongoing participation in clearing, in the event of a default or disruption in the system.

A clear framework to protect investors will ensure that they can continue to play this foundational role in the clearing system and should be a key focus of the CMU.

Pillar Three: A company-oriented vision for capital raising in Europe

Ed Cook

Co-head of BlackRock's Global Capital Markets Group

From an investor perspective, a CMU that can create a viable pathway to attractive investments would be meaningful.

As the provision of capital must be a mutually-beneficial exercise for both the investor and the issuer, we believe that the next phase of the CMU should take realistic stock of how companies are turning to markets to raise capital today, and seek to build out a policy agenda that can help relieve any potential frictions observed in how capital efficiently gets from the markets to companies.

On top of this, improvements to the structure of investment vehicles that help asset owners provide capital to companies and different stages of growth more efficiently would help grow the investor base.

8. Re-imagine the 'funding escalator'

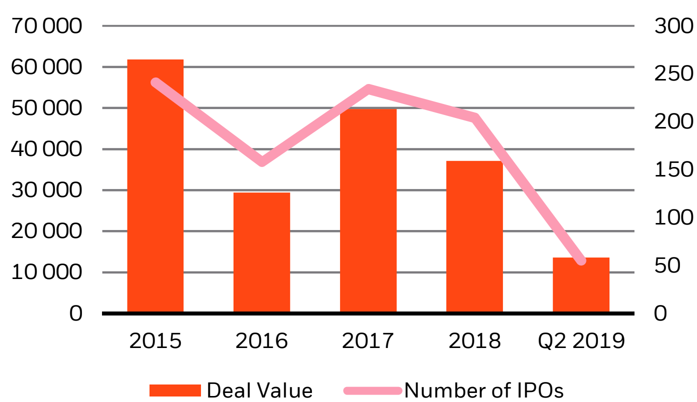
Developing the landscape for early-stage equity investment and facilitating increased public listings has been a key focus of the CMU to help support innovative, growth-oriented European companies. While there has been an increase in the pre-IPO risk capital coming from capital markets to European companies[14], it is less clear that the vision of a notable increase in IPOs has been realised (Exhibit G).

The central narrative of this facet of the CMU agenda has largely revolved around the vision of a pathway to public equity finance, the so-called 'funding escalator'. However, it is clear that in the years since the CMU vision was first articulated, the relationship between companies and capital markets has changed considerably (this trend was already emerging in 2015) with many companies staying private for longer, without a meaningful impact on their ability to raise capital. So is a policy framework built on delineating a path to listing still the right model for the CMU?

While there is a broader public interest served in having a healthy universe of listed companies, there are also good reasons why some companies – in particular, innovative, high growth companies – are choosing to stay private for longer.

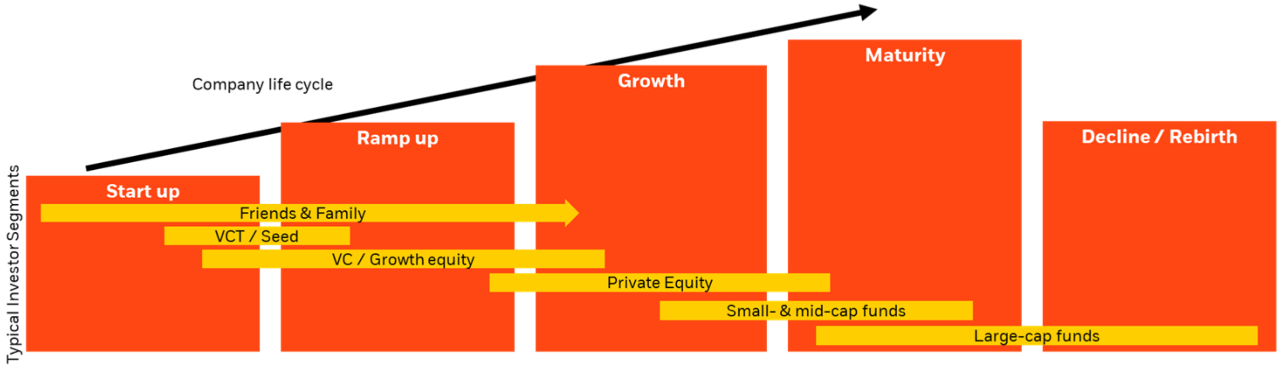
Exhibit G: European IPO activity since 2015

Deal value in €m



Source: PWC IPO Watch Europe, IPO Watch Data Explore Exchange

Exhibit H: The traditional 'funding escalator'



Source: BlackRock. For illustrative purposes only.

The cost of listing was a key focus of the first CMU agenda, but this did not address the ongoing cost of being a listed company, such as additional compliance, regulatory and reporting costs. Along with the growing number of companies who choose to remain private, many investors are increasingly interested in private market investment, which in turn results in the increased availability of different forms of finance while companies remain private.

On the traditional concept of a funding escalator (Exhibit H), a company goes through distinct growth phases where it raises capital from different specialist investor bases, where listing is the clear destination for the company to raise additional public financing and/or for many early stage investors to realise the returns on their investments.

This vision may not match the intended path for many companies, or indeed, all investors. More investors are increasingly interested in remaining invested in the company through different phases of growth. And for a company, the ability to deal with some of the same investors throughout different stages of growth and for various types of funding needs can be attractive as it reduces the need and therefore cost to 'remarket' itself to different types of investors throughout different stages of growth.

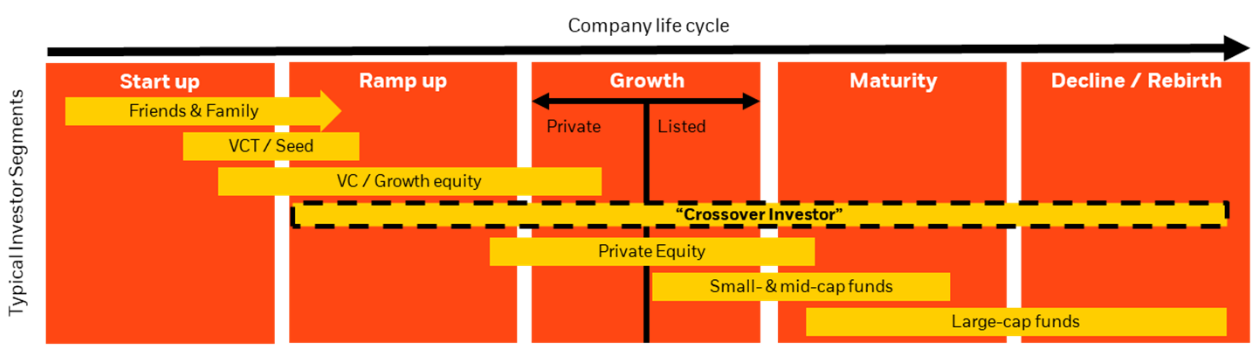
9. Optimise the ELTIF structure and tax framework for investors to better deploy capital

Looking clearly at companies' capital needs, and their growth patterns should be the basis for a renewed focus on how best to match capital with companies under the next phase of the CMU. **Investors' increasing willingness to provide capital throughout numerous different stages of company growth is of mutual benefit to companies and investors. Policy should seek to facilitate this through optimising vehicles investing in private as well as public assets.**

We see some of the new CMU initiative-related fund vehicles, such as the ELTIFs, European Venture Capital Funds (EUVECAs) and European Social Entrepreneurship Funds (EuSEFs), as potentially able to deliver innovative investment approaches that can help channel different types of capital investment to companies regardless of their position (or trajectory of progress) on the 'funding escalator'.

The ELTIF structure in particular seems well-suited as a vehicle to help asset owners provide capital in the role of 'crossover investor' (Exhibit I) and in particular to be able to give a wider investor base access to long-term investment strategies that can invest in companies at different stages of growth.

Exhibit I: The potential of the 'crossover investor'



Source: BlackRock. For illustrative purposes only.

Fund vehicles to help deliver sustainable investment objectives

The EU Sustainable Action Plan focuses heavily on enabling retail investors to deploy their capital in support of sustainable investment objectives. A key foundation of this is the development of an EU taxonomy to support the identification of investments that support those objectives.

The proposed taxonomy – because it focuses on identifying very specific 'economic activities' as sustainable – may be unsuitable as a framework to assess investment approaches that focus on exposure at the company level (e.g. equities and many fixed income instruments). We do, however, see it as a foundation to open up new investment approaches and opportunities for investors.

In particular for retail investors, it will be important that there is a viable fund vehicle that can offer them exposure to the types of project finance instruments most likely to be used to fund taxonomy-aligned activities.

For green bonds, as tradeable securities, this may be a UCITS structure. Other forms of direct investment and finance may require a vehicle that can invest in unlisted instruments the ELTIF may be the most viable structure.

We therefore encourage the European Commission to work with Member States to incentivise investments into the ELTIF by defining a solution that eliminates the current double taxation hit that many cross-border end-investors suffer when investing in the ELTIF.

But the ELTIF structure and framework must be further optimised to allow it to better play this role as the vehicle of choice for long-term capital provision. We see two main categories of improvements that would be meaningful changes to the ELTIF framework:

- **Structural:** The ELTIF is designed to be an investment vehicle that can provide long-term exposure to a range of long-term assets, but there is often a lack of clarity in ELTIF rules over investment in 'real assets' (e.g. infrastructure, real estate), and financial undertakings (which may be attractive early stage investments). Equally, the complex structure of the ELTIF and related national regimes mean that there are additional layers of cost for ELTIF investors. As the ELTIF framework is reviewed in the near future, we believe that amendments to these rules can lead to a structure that better serves the intended investor base, as well as more easily invest in companies and projects.
- **Distribution:** The product was designed to allow retail investors to participate in long-term investment strategies, and indeed we do see appetite and potential for this. However, MiFID distribution rules do not align with the ELTIF's intended market and a cumbersome cross-border marketing process inhibits the ability to scale products. Updating the MiFID investor definitions and target market rules would enable the ELTIF to realise its potential as a retail investment vehicle.

Equally, tax is a critical consideration for ELTIFs. Beyond the challenge of navigating different national tax treatments for ELTIF investors, there is added complexity in the treatment of cross-border investments at the fund level.

For investors, the taxation on dividends and capital gains in some EU jurisdictions, as well as the requirement to appoint a withholding tax agent, make the ELTIF unattractive to retail investors. At the fund level, we continue to raise concerns with the tax implications of the OECD Base Erosion and Profit Shifting (BEPS) framework[15] for funds that invest cross-border in unlisted investments.

The purpose of the BEPS rules was twofold: to curb double non-taxation or tax avoidance by multinational companies, and not to create new rules that result in double taxation. While the BEPS framework makes some accommodations for funds who invest in listed securities (called Collective Investment Vehicles, or CIVs), generally speaking, funds which invest in real assets such as infrastructure, unlisted securities or other types of direct investments ("non-CIVs") on a cross-border (even intra-EU) basis will lose some of their tax-neutrality by losing access to tax treaties.

While a comprehensive global solution for non-CIVs has not been found, we believe that an EU-level solution for ELTIFs (at least) would be possible and would make such funds more attractive to end-investors. This framework would enable funds to continue to invest in assets on a cross-border basis, while delivering the necessary transparency and a fair outcome to both investors and tax authorities.

At the global level, we believe implementing a 'TRACE 2.0' (a technology-focused successor to the OECD Treaty Relief and Compliance Enhancement programme[16]) would give governments transparency and reduce the administrative barriers that currently affect the ability of investors to access the tax treaties to which they are entitled.

Conclusion

We believe that an investor-centric CMU framework – with increased investment opportunities and protection of their interests as their capital is channelled through markets and invested – will provide meaningful incentives for European savers to commit capital to European markets. This will not only help realise the broader aims of the CMU, but equally help the CMU support the other key EU priorities on which promoting investment rests.

A CMU that can be an important vehicle for helping European citizens better engage with the system of investment services and product provision will pay dividends in promoting greater financial well-being among European citizens, providing more financing opportunities for European companies, and helping to address longer-term challenges such as the pensions gap, and funding sustainable investment goals.

Furthermore, a deeper European investor base whose capital is invested in Europe and globally, paired with European capital markets which remain open to global investment, will translate into a more central role overall for European capital markets globally – increasing the attractiveness of Europe as place to do business, and providing a stronger 'engine' to drive growth and long-term economic well-being for European citizens.

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