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ICMA BRIEFING ON THE IMPORTANCE OF INTEGRATED CAPITAL MARKETS AND CMU

INTRODUCTION

1 The International Capital Market Association (ICMA – EU Transparency Register number: 0223480577-59) represents issuers, lead managers, dealers, asset managers, investors and market infrastructure providers in the international capital markets. ICMA has over 570 members, based across Europe and globally, and has set standards of good market practice in the international fixed income market for over 50 years.

2 ICMA’s mission is to promote resilient well-functioning international and globally coherent cross-border debt securities markets, which are essential to fund sustainable economic growth and development.

3 Capital Markets Union (CMU) has been a major initiative of the outgoing European Commission. Launched in September 2015, the European Commission’s CMU Action Plan was built around four principles:

- (i) creating more opportunities for investors;
- (ii) connecting financing to the real economy;
- (iii) fostering a stronger and more resilient financial system; and
- (iv) deepening financial integration and increasing competition.

4 There is a significant degree of consistency between ICMA’s mission and the objectives of CMU, given which ICMA has supported CMU from the outset and continues to see significant value in the further development of the CMU concept. The element of integration inherent in this concept is a point that is integral to much of ICMA’s work, which strives to avoid unnecessary market fragmentation and disruption given that such aspects run counter to the development of deep, liquid, efficient markets.

COMMENTARY

5 ICMA understands and supports efforts which have been made to achieve financial stability, which in overall terms is in everybody’s interest. Nevertheless, ICMA is concerned that the regulatory response to the crisis has comprised a series of individually designed measures without there being an overall understanding of the way in which the pieces would fit together. Accordingly, it is very welcome that ongoing efforts are being made to evaluate impacts and is important that there be a willingness to recalibrate elements in order to try and address unintended consequences.

6 ICMA has been particularly concerned about impacts on the market, especially ways in which regulation has created fragmentation. Our studies have shown the importance of fixed income markets as a financing channel and drawn attention to the fact that increasing regulatory burdens, in particular tighter capital constraints on banks, have put market making activities, in both cash bonds and repos, under significant strain. This implies that a higher price should have to be paid on bond issuance in order to cover the reduced market liquidity – although this has been masked by the exceptional monetary policy measures taken by Central Banks which have, for important and well-intentioned reasons, continued to make available large amounts of cheap cash and thus acted to compress issuance spreads.

7 Europe's direct regulation of markets, in particular through MiFID II has added costs and complexity while failing to adequately deliver intended benefits. Much work is needed to clean up data and make better information available, including through the establishment of a suitably designed and governed consolidated tape. CSDR market discipline will helpfully bring in a regime of settlement penalties, but also includes the imposition of mandatory buy-ins which are very poorly suited to fixed income markets and liable to simply drive more liquidity out of the market. Combined reporting burdens, particularly including those under MiFID II, EMIR and SFTR, are significant and ought ideally to be streamlined in order to more efficiently and cost effectively deliver accurate, timely information.

8 CMU is conceptually a good further step to develop well-integrated EU capital markets, all the better to boost financing options and meet the challenges of continuing to deliver economic growth in mature economies, but despite progress on many potentially worthwhile initiatives, results thus far have been underwhelming in their impact. Many measures are only just agreed by the co-legislators and their effects therefore remain to be seen. Others are further advanced but there have been significant problems with implementation, including where Level 2 technical standards have not been agreed in time.

9 The STS Regulation has thus far proved especially problematic, with the challenge of complying with its incompletely specified multiple requirements serving to constrain rather than boost securitisation and threatening to eliminate ABCP in Europe. The new prospectus regulation may be significant for EU capital markets, but when placed alongside the constraints imposed by MiFID and PRIIPS will not do anything to boost meaningfully the development of retail fixed income markets, albeit that bonds should in principle be more retail-friendly than (first-loss exposed) equities.

10 New regimes established for European long-term investment funds (ELTIFs) and for the pan-European personal pension product (PEPP) are further examples of important steps taken which move in the desired direction. Yet, in each case, the potential of what has been done is hampered by the introduction of too many detailed constraints, leaving it likely that the take-up of these new forms of investment vehicle will fall far short of the desired level. While remaining respectful of the need to provide the right degree of control to satisfy legitimate concerns, such as investor protection, more work to better facilitate take-up of these vehicles could boost their contribution towards the financing of much needed longer-term investment – to the benefit of the real economy.

11 Continuing to build and develop CMU offers benefits but also potentially brings new risks, which should of course be carefully considered and suitably addressed. For instance, the aim of complementing the bank financing channel and hence avoiding excessive economic retraction during periods of bank instability or weakness should not be allowed to be undermined by market risks introduced through the capital market channel and spread across borders by the union dimension of CMU. Already much progress to adapt EU supervision and oversight, especially through the establishment of the ESFS, has been made. This foundation can continue to be appropriately built upon, in parallel with the journey towards the realisation of CMU. This evolution should remain mindful of the distinction, which can be expected to remain even in an EU single market context, between retail markets that have a strong domestic orientation and wholesale markets which act widely across borders, both inside the EU and in a broader global markets context. Linking this to continued efforts to ensure that the EU's single rulebook is consistently administered across the whole of the EU can potentially bring at least as much benefit as the promulgation of yet more rules and regulations.

12 It is also widely recognised that CMU is a complement to the EU's well-advanced endeavour to introduce Banking Union. Completion of the latter is of significant importance, not only to ensure that the objectives of Banking Union are secured, but also since the CMU can itself benefit from the EU having a robust EU-wide banking system – given that banks are themselves important actors in capital markets. Alongside this, progress with other initiatives to further strengthen the Economic and Monetary Union also offer significant potential to act in ways which will greatly benefit CMU and vice-versa. Two elements discussed in this context which are particularly germane are the possible steps to boost the international role of the euro and the examination of how to create a European safe asset. Each of these can do much to add to the strength and depth of European markets, making them more attractive and better able to deliver CMU's objectives.

13 Brexit adds a significant further layer of complexity, exacerbating the risk of market fragmentation and ICMA has contributed to efforts to avoid or mitigate cliff-edge risks. The EU27 continue to anticipate wishing to develop capital market capabilities (ie CMU looking ahead) but greater clarity is needed about how best to do this in a way which maximises the opportunity to attract investment to Europe through open and integrated capital markets, as opposed to cutting off Europe through excessively inward-looking protective measures.

14 The coming debate about the EU/UK relationship and the extent to which a model of regulatory equivalence can facilitate market access, suitably respecting the importance of safeguarding EU markets and their users while also facilitating their abilities to benefit from UK financial market capabilities, will prove important as Brexit progresses. Other regulations, such as the EU BMR, already illustrate the difficulty of creating EU rules which go beyond those anticipated elsewhere while, at the same time, suggesting that equivalence is the way to accommodate third country considerations. Appropriately and pragmatically resolving these tensions, also evident in recent decision making regarding the EU's relationship with Switzerland, will play an essential part in shaping the U's future position in global capital markets. Done well, this can bring significant value to the financing of the EU's economy and help the EU to achieve better outcomes in a highly competitive global environment.

15 The swift rise in focus on sustainability has been anticipated by the significant development which ICMA has helped to guide in relation to green and social bonds, working through market-led principles. Taking note of this some countries have already moved to legislate, and the EU is now progressing rapidly along this path, with its taxonomy and green bond standard proposals, together with steps to integrate sustainability in other regulations, such as MiFID II, UCITS and AIFMD. There is much further to go on this journey and CMU will need to be shaped in such a way that it helps to drive the coming shift to sustainable finance.

16 Alongside this, at the same time as technological development holds the potential to boost economic productivity in most fields of human endeavour, FinTech offers a way in which to potentially rise to many of the challenges of formulating and regulating better markets. By thinking ahead, rather than looking back, the EU can seize this opportunity to build and develop its market capability in ways which already integrate and capitalise upon the potential which digitalisation offers, while simultaneously instigating safeguards in respect of associated technological risks.

17 While many more detailed steps need to be taken to progress CMU and better fulfil its objectives, ICMA considers that there is a big opportunity which currently lies in front of the EU is to fully exploit the synergies between each of the CMU, the sustainability action plan and the FinTech action plan. At the same time, it will be essential to maintain the EU's competitiveness in globally interconnected capital markets and to avoid that the fragmentation inherent in Brexit has an unduly negative impact. These key points are elaborated on in the following four pages.

CAPITAL MARKETS UNION AND BREXIT

18 There is a strong case for the CMU project to continue in the EU27 when, as should continue to be anticipated, the UK leaves the EU, since capital market financing represents a lower proportion of total financing in the EU27 than in the UK, and the need for the EU27 to develop capital markets to finance growth is correspondingly greater than in the UK.

19 Even so, the proposed withdrawal of the UK from the EU represents a significant risk to the potential benefits which CMU can bring to Europe as a whole, given London's role as an international financial centre. Oliver Wyman, for example, estimates that over 75% of the EU's capital market business is conducted through the UK.¹ London is expected to continue to have an important international role, even as some of London's business moves to different financial centres in the EU27 in response to Brexit.

20 How can the impact of UK withdrawal from the EU on the CMU project be minimised?

- EU law will continue to apply in the UK until Brexit day, including new EU legislation between now and Brexit day. The UK Government is legislating with the intent of ensuring that, on Brexit day, all existing EU law will become UK law. EU Directives are already transposed into UK law. But EU Regulations (and various technical standards which underpin the operation of both EU Regulations and EU Directives) currently apply directly in the UK. These will therefore cease to apply from Brexit day unless the UK does indeed successfully pass legislation which provides that they should continue to apply in the UK after Brexit. The intended UK legislation is not just a "copy and paste" exercise, and there is also a risk that it will be amended during the continued period before it enters into force. But the UK Government's intention remains that, on Brexit day, capital market regulation in the UK and in the EU27 should effectively be the same.
- The EU27 need to continue to reassess how well its financial legislation will function post-Brexit without the UK, as it has been doing for instance in the EMIR review.

21 The UK Government has proposed that the UK should leave the Single Market when it leaves the EU but plans to negotiate access to the Single Market as a third country. It remains to be seen whether the UK will remain equivalent with regulation in the EU27 and whether appropriate regulatory and supervisory arrangements can be maintained between the FCA and ESMA. There are still some technical difficulties relating to equivalence which need to be overcome during the bilateral negotiations between the UK and the EU27. But if negotiations between the UK and EU27 break down, as they still might – given the difficulties experienced thus far in the Brexit process and the attendant political uncertainties, there is a real risk that UK and EU27 regulation and supervisory convergence will start to diverge after Brexit.

¹ Oliver Wyman: *EU Scenarios and the UK Financial Centre*: 2014.

CAPITAL MARKETS UNION AND GLOBAL COMPETITIVENESS

22 It is important to ensure that the EU regulatory framework for financial services remains competitive in relation to the rest of the world. The European Commission should place global competitiveness of the EU regulatory framework at the heart of its CMU project.

23 ICMA considers that the Commission has been overly inclined to focus on the reform of the EU Single Market from an internal perspective, without emphasising sufficiently the need to ensure that the EU regulatory framework is globally competitive. Firms based in the EU need increasingly to export their products and services to the rest of the world and, in doing so, regulatory costs and constraints are an important factor. The EU also needs inward investment from the rest of the world. This requires a predictable and robust legislative environment. That is not always currently the case. For example, the complexity of complying with the EU legislation on simple, transparent and standardised securitisation risks making the EU uncompetitive and unattractive to non-EU investors.

24 At a time when the benefits of globalisation are being called into question and the world's global trading patterns are stressed by the unfolding tensions between the US and China, the global competitiveness of the EU regulatory framework is likely to be of increasing importance. But the importance of maintaining the EU's global competitiveness should not be seen as engaging in regulatory competition. Rather, it should require intense focus on maintaining effective EU-wide regulation in a manner which is proportionate, and which does not unnecessarily inhibit business flows into or out of the EU. In a globally competitive marketplace, this will necessitate continued efforts to well balance appropriately determined and applied EU and Member State requirements alongside global standards.

CAPITAL MARKETS UNION AND SUSTAINABILITY

25 To ICMA, the European Commission's thinking on its sustainability strategy seems thus far to have been that it is consistent with the objectives of the CMU and yet separate from it. ICMA sees this best summarised by the following quote from the EU Action Plan on Sustainable Finance:

- “The financial system is being reformed to address the lessons of the financial crisis, and in this context it [the financial system] can be part of the solution towards a greener and more sustainable economy. Reorienting private capital to more sustainable investments requires a comprehensive shift in how the financial system works. This is necessary if the EU is to develop more sustainable economic growth, ensure the stability of the financial system, and foster more transparency and long-termism in the economy. Such thinking is also at the core of the EU's Capital Markets Union (CMU) project.”

26 From a practical perspective the various sustainability initiatives that are underway, whether in embedding sustainability in existing legislation (eg MiFID II, IDD); new legislative proposals for disclosures; an EU Taxonomy; or voluntary guidance via an EU Green Bond Standard, are consistent with the CMU, as they are being designed to be applied across the EU and supervised where relevant via ESMA.

27 There is however a risk of fragmentation that could emerge as a result of pushes, for example, for national sustainability standards; labels for financial products (such as for green bonds or green funds); national taxonomies; or delegated national interpretation of the future EU Taxonomy. It is in these areas that we should be focusing to avoid diverging practices that would also undermine the objectives of CMU.

28 More challenging, there is a trend in the Trilogue process to shift the Commission's proposals towards more mandatory measures and/or ones that may crystalize liabilities in green finance markets, in a manner that could create disincentives for the market's further development in contradiction with the objectives of the EU's Action Plan and of the CMU.

29 Looking ahead, it appears to ICMA that it is essential that CMU and the Sustainability Action Plan become fully integrated parts of a single strategy, the better to ensure that the complementarity of these important initiatives can be most fully leveraged – to the benefit of each.

CAPITAL MARKETS UNION AND FINANCIAL TECHNOLOGY

30 ICMA considers that, thus far, the focus on FinTech within the CMU key building blocks has been rather limited. The only legislative measure directly linked to FinTech is the proposal for a crowdfunding regulation which is aimed at start-ups in particular and was put forward in the European Commission's FinTech Action Plan, released in March 2018.

31 In the FinTech Action Plan, the Commission set out a number of non-legislative proposals to promote FinTech such as:

- Easier and more uniform licensing rules for new FinTech activities;
- Align standards;
- Supervisors help FinTech firms apply rules and access market ("innovation facilitators");
- Regulatory sandboxes – supervisors to apply rules to FinTech firms in a flexible and proportionate way.

32 That said, in its FinTech Action Plan the Commission noted that "drawing on the conclusions from the public consultation in March - June 2017 and taking account of the initiatives already presented, the Commission considers that the case for broad legislative or regulatory action or reform at EU level at this stage is limited. A number of targeted initiatives for the EU to embrace digitalisation of the financial sector are, however, warranted." Since then, a number of initiatives and reports have been launched, such as the EU Blockchain Forum and Observatory, a report on sandboxes and innovation hubs and best practices, crypto assets etc.

33 There is a "Regulatory obstacles to financial innovation Expert Group" (ROFIEG) which will be publishing a report in June (with a broader focus than just capital markets). While there have been updates at the ECB-FinTech Task Force, visibility on ROFIEG's concrete proposals remains rather limited, but ICMA anticipate that there will be several relevant points with regard to CMU.

34 Harmonisation of regulatory and supervisory practices, as well as maintaining a level playing field across the EU in respect of FinTech would be critical for CMU. That said, ICMA is aware that the Commission's scope for (legislative) actions is quite restricted given that challenges arising from FinTech (eg use of particular technologies and licensing requirements) often relate to the national regulatory framework, which is also reflected in the various non-legislative measures put forward in the EC FinTech Action Plan. However, the objectives of the FinTech Action Plan to create "a more competitive and innovative financial market" are complementary to the CMU's objectives and it would be beneficial for these to be closely aligned going forward.

35 Looking ahead, it appears to ICMA that it is essential that CMU and the FinTech Action Plan become fully integrated parts of a single strategy, the better to ensure that the complementarity of these important initiatives can be most fully leveraged – to the benefit of each.

ANNEX

Additional Detailed Observations Regarding Specific Work to Further Fulfil CMU Objectives:

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The 22 recommendations of the Commission Expert Group on Corporate Bond Markets

36 Integrated, efficient and resilient corporate bond markets are a vital and core pillar of a successful CMU. Strong corporate bond markets will give businesses access to more diverse sources of funding and offer Europeans more investment opportunities.

37 In the context of the CMU initiative, the Expert Group on European Corporate Bonds has been mandated by the European Commission to analyse and propose recommendations to improve the functioning of the corporate bond markets in the EU. The Expert Group analysed the functioning of corporate bond markets from the perspectives of issuers, investors and intermediaries. They formulated 22 recommendations pursuing six objectives:

- (i) making issuance easier for companies;
- (ii) increasing access and options for investors;
- (iii) ensuring the efficiency of intermediation and trading activities;
- (iv) fostering the development of new forms of trading and improving the post-trade environment;
- (v) ensuring an appropriate level of information and transparency; and
- (vi) improving the supervisory and policy framework.

38 The findings and recommendations of the Group were published in the November 2017 report, [Improving European Corporate Bond Markets](#). An accompanying report, [Analysis of European Corporate Bond Markets](#), provides the supporting analysis underpinning the recommendations. Following the publication, the Commission announced that it would undertake a public consultation on the reports and their recommendations.

39 ICMA believes that the objectives and work of the Group remain highly relevant and would encourage the Commission to pursue the projected consultation. Among the recommendations some will be critical considerations in ensuring the development of a deep, liquid, and efficient secondary market for pan-European corporate bonds, not least:

- A review of the capital and liquidity requirements for corporate bonds based on a quantitative assessment of their impact on market-making and corporate bond liquidity.
- A rethink of the timing and provisions for the CSDR mandatory buy-in regime.

The recommendations of the European Post-Trade Forum

40 The EPTF was the latest in a long line of efforts made to examine impediments to the evolution of an efficient EU Single Market for the processing of securities transactions. ICMA recognizes that much has been done, such as the creation of T2S, yet, as already noted by the EPTF, much more remains to be done. Understandable changes to establish welcome conditions to help assure financial stability are as yet incomplete and this work must continue. But the need to advance the CMU, to facilitate investment, jobs and growth, is equally important. This creates a clear need to look both at detailed questions about EPTF barriers, but also at how to address the wider issues which continue to cause well-known barriers to persist.

41 There are many examples of the way in which the EU's market infrastructure remains the sum of its historical parts, rather than a single coordinated EU-wide whole, thus impeding cross-border activity as elements of market fragmentation at Member State level remain unaddressed. This represents a big opportunity for the creation of a more competitive EU Single Market and is a competitive necessity in a world of global financial markets where others, including the US, enjoy the benefits of well-unified markets' infrastructure.

42 Change will yet take time, but a clearly understood path is needed to rationalise how the EU's markets work, building towards an integrated EU Single Market and moving beyond the current stack of domestic market pieces. Within the euro area the opportunity and imperative is even greater, given the valuable underpinning role which the single currency is capable of playing across this bloc. All layers need to be worked on, from trading through clearing, settlement and reporting. Each has already faced big changes, witness MiFID II, EMIR, CSDR and SFTR, but in the short run this has often added yet more complexity to the already fractured EU markets' system, while an integrated EU-wide result needs to benefit from significant streamlining.

43 Centralised liquidity and collateral management should be fully enabled across the EU, with the successful technical implementation of T2S being merely a first milestone in a much longer journey. This needs to be supported by well organised supervision, which itself may need to become more centralised or at very least far more coherent, and coordinated, rather than duplicative and inconsistent reporting requirements. The public sector needs to solicit the assistance of the private sector to help design and implement the changes which could bring this about, engaging with the full range of market participants – issuers, intermediaries, investors and infrastructures alike.

44 As part of their mandate to

- (i) review the remaining, or any new, barriers to an integrated post-trade environment in the EU; and
- (ii) to provide technical advice to the Commission on follow-up actions,

the EPTF members also discussed possible barriers that are already visible and potentially emerging over the next few years. The inclusion of these barriers "on the watchlist" was intended as an alert for public authorities about areas where there was no immediate or urgent need for action. The EPTF acknowledged that, in some cases, it should be recognised that some action has already been taken to address the root causes of these obstacles and there was only a recommendation for continued monitoring of progress towards full implementation or resolution.

45 However, for the topics included in the EPTF's watchlist section various signs of difficult conditions were emerging, that might evolve into the creation of significant barriers if not adequately monitored or controlled. This section of the EPTF's report focused on five barriers:

- (i) national restrictions on the activity of primary dealers and market makers (formerly Giovannini Barrier 10);
- (ii) obstacles to DvP settlement in foreign currencies at CSDs;
- (iii) issues regarding intraday provision of credit to support the settlement process;
- (iv) insufficient collateral mobility; and
- (v) non-harmonised procedures to collect transaction taxes (formerly Giovannini Barrier 12).

46 Since the time of the EPTF's report, the ICMA's European Repo and Collateral Council (ERCC) believes that some of these barriers have developed in significance and that it is crucial that they be afforded as much attention as the other EPTF barriers.

Efficient repo markets and collateral fluidity

47 In many ways, the repo market represents the foundation stone of the financial system, vitally facilitating the flow of cash and securities across the system. More broadly, the SFT markets play a crucial and central role in the modern financial ecosystem, facilitating a number of critical functions and interacting with a variety of different financial markets and their users.

48 The post-crisis reforms have led to a financial system that depends on high-quality collateral that has low volatility and a high degree of liquidity as its foundation. The system has more concentrated inter-connectivity with derivatives clearing requirements, limited unsecured funding capacity and higher mitigation of counterparty risk, using collateral. Therefore, it is imperative that the system has adequate capacity to move high-quality collateral – mainly through SFTs – across the system to where and when it is needed by market participants.

49 Regulation is a key driver of changes in the way the repo and broader SFT markets operate today and how they will evolve in the near future. While the markets have thus far proved resilient, they are still some way from reaching a new normality, with regional markets at different stages of that evolution reflecting divergent implementation of regulatory reforms on different timelines. This in turn influences the need for central banks to step in and provide capacity particularly at key reporting dates, such as year-ends when multiple regulatory and other measures such as bank levies encourage banks to reduce balance sheet capacity allocated to low-risk/ low return activity. This is of particular concern given the need for the private sector to absorb the unwind of QE programmes over the coming years.

50 The impact of future regulatory reform is a key concern across all jurisdictions. The implementation of forthcoming regulations such as the NSFR and the SFT minimum haircuts framework could further constrain capacity, to the detriment of the market. Unless revised, the SFT haircuts framework would increase SFT RWAs significantly, with over half of that impact coming from securities borrowing. This would have detrimental impacts on the repo and securities lending markets:

- Securities lenders may have to accept significantly lower returns for their portfolios due to lower demand;
- Dealer banks may not be able to provide the same level of liquidity in case their ability to borrow securities to meet client demand is limited due to the haircut rules;
- Short-sellers may need to seek for alternative ways to “short” securities and improve the price discovery process;
- Increased costs and reduced capacity for transacting with regulated counterparties could ultimately lead to increased costs for investors in pension funds and mutual funds.

51 There is a need to review the coherence and calibration of the post-crisis regulatory framework pertaining to how it impacts the repo market. As evidenced in the literature and the primary research, in particular the treatment of repo transactions backed by the highest quality government bonds should be reviewed in order to ensure that the private sector market has the capacity to absorb QE unwind and to operate without significant reliance on central banks during normal and stressed market conditions.

These themes are discussed in more detail in the 2018 [*GFMA and ICMA Repo Market Study: Post-Crisis Reforms and the Evolution of the Repo and Broader SFT Markets*](#).

Consolidated tape for fixed income

52 Directive 2014/65/EU (MiFID II) provides for the possibility of establishment of a consolidated tape (CT) both for equity as well as for non-equity financial instruments. The intention of the regulation is to create a framework that provides commercial incentives for operating a consolidated tape. In the case of bond markets, however, remains problematic for a number of reasons:

- (i) Currently there are a number of approved publication arrangements (APAs) providing post-trade data for bond markets, using different approaches and formats. There is no easy or inexpensive way of aggregating and consolidating all this data in a standardized format.
- (ii) Potential consolidated tape providers (CTPs) are likely to wish to compete in providing a consolidated tape, resulting in multiple consolidated tapes. There is no commercial incentive for data firms to cooperate to produce a single-source CT.
- (iii) Providers of CTs are likely to wish to do so as part of their regular commercial vendor services and not as a regulated CTP.

53 Since a stated objective of MiFID II is to create greater post-trade transparency for non-equity markets and to provide an even playing field for all market participants, the current regulatory framework for a CT seems destined to fail. Given the potential for post-trade data to be provided from multiple sources, to achieve a full and overview of post-trade data firms will be required to invest in accessing and consolidating data from a range of CTPs or pay for a third-party aggregation service. This will clearly disadvantage smaller market participants.

54 ICMA supports the concept of a consolidated tape for fixed income. However, further work is required to determine the most suitable approach to the governance and operational management of such a consolidated tape.

European Long-Term Investment Funds (ELTIFs)

55 The European Commission launched the proposal for a Regulation on ELTIFs in June 2013, to create a new brand of fund available for both retail and professional investors to invest in long-term illiquid assets. The European Council and Parliament agreed on the legal text in December 2014, following which the ELTIF Regulation was published in the EU's Official Journal on 19 May 2015. It entered into force on 9 June 2015 and has applied since six months later, ie from 9 December 2015, notwithstanding that the associated Delegated Regulation with regard to regulatory technical standards was not finally published in the EU's Official Journal until 23 March 2018.

56 The ELTIF rules are designed to be closely linked to the Alternative Investment Fund Managers' Directive (AIFMD), with ELTIFs being AIFs that are managed by AIFMs duly authorised according to the AIFMD framework. The Commission justified the need for a European framework for these kinds of funds on the grounds that different existing fund structures already exist at national level, which lead to diverging levels of investor protection, different legal certainty and differing redemption and holding period rules. By seeking to create a new harmonised fund structure, which would be passportable across the EU's single-market, the Commission hoped to ensure that ELTIFs would display a coherent and stable product profile for investors to invest in; but a number of national considerations, not least among which is tax, continue to impinge on this.

57 The final ELTIF text notes that, while individual investors may be interested in investing in an ELTIF, the illiquid nature of most investments in long-term projects precludes an ELTIF from offering redemptions to its investors. For this reason, the default structure of these funds should be not to offer any redemption before the end of the life of the ELTIF. However, given the importance of redemptions for retail investors, the ELTIF manager is given discretion in the legislation to decide whether to grant early redemptions to investors under certain conditions. Furthermore, while ELTIFs are not by default designed to offer redemptions, there is nothing preventing an ELTIF from seeking admission of its shares or units to a regulated market or a multilateral trading facility. In other words, there will still be the possibility of secondary market liquidity if investors want to sell their units.

58 There are also minimum ticket restrictions on retail investors. A retail investor whose portfolio composed of cash deposits and financial instruments is smaller than €500,000 is not allowed to invest an aggregate amount exceeding 10% of his portfolio in ELTIFs, provided that the initial amount invested in one or more ELTIF are no less than €10,000 (although if investing in more than one ELTIF the minimum in any one ELTIF out of the €10,000 is €2,000). The relevance of establishing limits is easy to appreciate, yet the way these are structured leads to a requirement which is challenging to apply – as it is far from straightforward to be able to monitor compliance with these limits.

59 The portfolio rules for ELTIFs state that at least 70% of the ELTIF's capital should be invested in "eligible investment assets" – ie long-term assets. These long-term assets are generally illiquid assets, which are not transferable and therefore do not have access to liquidity in secondary markets. These eligible investments must be in equity, debt or loan instruments issued by what are known as "qualifying portfolio undertakings", which include listed companies up to a capitalisation of €500 million. Eligible assets also include direct holdings of "real assets", so long as they provide a predictable stream of cash flows and have a value of more than €10 million, eg infrastructure or property. Investment in other ELTIFs, or in European Venture Capital Funds (EuVECAs) or European Social Entrepreneurship Funds (EuSEFs), is allowed up to 20% of the capital of the fund or up to 25% of the total units in this other fund. This has been criticised by the fund industry, as it restricts effective fund of funds solutions in these illiquid assets.

60 While remaining respectful of the need to provide the right degree of control to satisfy legitimate concerns, such as investor protection, more work to better facilitate take-up of ELTIFS, and other similar longer-term investment vehicles, could significantly boost their contribution towards the financing of much needed longer-term investment – to the benefit of the real economy.

The search for a euro safe asset

61 The idea of a public “safe asset” attracted attention in the wake of the euro sovereign crises, where a safe asset could not only provide emergency funding for stressed euro member economies but would also help to break the “doom loop” of the sovereign-bank nexus. More recently the discourse has begun to focus on the increasing demand for high-quality liquid assets in a more collateralised financial system. From a central bank perspective, the potential for a safe asset is seen as helping to make the euro a more investable currency while also facilitating the execution of monetary policy.

62 There has been much discussion around what should be the defining characteristics of a safe asset. The starting point is perhaps to distinguish safe assets from the broader class of high-quality liquid assets (HQLA). Generally it is held that a safe asset should not only be of the highest perceived credit quality, be deeply liquid, and have benchmark status (providing for a yield curve), but that it should be counter-cyclical in the sense that it should increase in value in stressed market conditions; importantly this should be due to a perception of quality and safety, rather than as a result of scarcity.

63 Other features considered essential include the capacity to create a deep, liquid derivatives market, the best treatment under regulatory capital and liquidity requirements, as well as central bank eligibility with the lowest possible haircuts. The US treasury market provides the archetypal safe asset, while in the euro area German government bonds currently serve the role – but this is a relatively limited pool of assets and one that is set to become even smaller.

64 While there may be broad agreement on the need for and desired characteristics of a euro safe asset, creating one is a lot more challenging. The first hurdle is that the possibility of a common, jointly guaranteed “eurobond” market has been roundly rejected on the grounds that this would reduce the incentive for “weak” economies to undertake necessary structural reforms and would undermine the stability and fiscal credibility of the euro area. Other considerations include not increasing the overall issuance stock of euro area sovereign debt and ensuring that there is not a detrimental shift in relative demand away from some domestic markets.

65 Despite these potential limitations, a number of possible solutions have been put forward that continue to engage academics, policy makers, and regulators, as well as market participants. These various proposals can be grouped into four main approaches: tranching and pooling existing sovereign debt; pooling with preferred intermediary creditor status (“E-bonds”); pooling of existing sovereign debt, followed by tranching (“ESBies”); and issuance backed by a euro area budget (supranational issuance).

66 While there are a range of alternative proposals under consideration, and a series of challenges and limitations to circumnavigate, it would seem that there is broad consensus among public and private stakeholders of the benefits, and even the need, to create a euro safe asset. In doing so, a number of questions still need to be answered. These include whether issuance should be demand or supply led, the involvement of the private sector in its creation, and whether a safe asset market should be developed gradually or if a “big bang” approach should be taken.

67 Variations on the four main proposals also deserve consideration, such as a proposed “temporary eurobill fund” (TEF). Effectively the pooling of short-term euro area issuance, this might not only be a manageable means of testing the water for safe assets, but it could also ease some of the strain being borne by the repo market in intermediating collateral flows, as well as creating a term risk-free reference rate for the euro area.