Preliminary Thoughts on the New Capital Markets Union Action Plan

On 24 September 2020, the European Commission (EC) published its second Capital Markets Union (CMU) Action Plan.

The International Capital Market Association (ICMA) supports the overall ambition and three key objectives of the new CMU Action Plan: (1) supporting a green, digital, inclusive and resilient economic recovery by making financing more accessible to European companies; (2) making the EU an even safer place for individuals to save and invest long-term; and (3) integrating national capital markets into a genuine single market. ICMA also agrees that capital markets can help the EU deliver on its key economic policy objectives. In this respect, we note that **the pan-European primary bond market is generally well developed and integrated currently**, and has been a **crucial source of funding** for EU businesses during the COVID-19 pandemic, with around €680 billion raised in international European debt capital markets in Q2 2020 (almost double the volume raised in the same period in 2019)[1].

ICMA welcomes the fact that some of the points raised in its preliminary thoughts and feedback on the High-Level Forum's (HLF) Final Report were included in the Action Plan. This includes, *inter alia*, a proposed review to strengthen the role of securitisation and the European Long-Term Investment Fund (ELTIF) Regulation.

Several of the EC's proposed actions relate to developing EU equity markets, particularly for SME funding. In pursuing these goals, and noting the crucial role that bond markets play in funding the EU's larger businesses, ICMA strongly believes that it will be **important to ensure that any measures do not unintentionally negatively impact upon the international bond market** and, where relevant, effective action is taken to strengthen and further integrate this market (particularly in relation to secondary trading and repo activity).

Against this background, ICMA sets out below key points of attention that require further consideration in order to effectively achieve the goals envisaged by the EC.

- **Encouraging long-term investment: Review of Solvency II and CRR/CRD (Action 4)**

Action 4 involves reviewing the Solvency II Directive (Action 4A) and CRR/CRD (Action 4B) with a view to encouraging more long-term and equity financing by institutional investors.

In relation to the **review of Solvency II** envisaged under Action 4A, ICMA encourages the EC to assess the impact and potential procyclical effects of **capital charges for downgraded bonds** in light of the recent crisis caused by the COVID-19 pandemic. While approaches to capital calculations vary across jurisdictions, insurers will generally need to hold significantly more capital against bonds that are downgraded. These requirements can cause institutional investors to adjust their portfolios in advance of a credit rating downgrade, with potential procyclical effects.

Under Action 4B, the EC envisages a **review of CRR/CRD** in order to ensure, among other things, that banks and investment firms can 'make markets' in company equity, while being subject to adequate prudential treatment. ICMA highlights that **the ability to make markets for non-equity securities is also very important** in order to allow investors to adjust their positions/exposure in these markets and to facilitate pricing of new bond issues which, as noted above, are crucial to funding the recovery

[1] Source: Dealogic. This and other Dealogic data (denominated in USD) is available on the ICMA website.

from the COVID-19 pandemic. Noting this, the role of market-makers in creating deep and liquid markets in bonds needs to be recognised. ICMA therefore encourages the EC to consider the **impacts of the CRR on fixed income market-makers, including related hedging and financing activity**, when it considers the position for equity markets.

In addition, if secondary bond markets are to be given due consideration, then **the CSDR mandatory buy-in provisions need to be reconsidered**. While recognising that settlement efficiency in fixed income markets is already relatively high, the imposition of a poorly designed, one-size-fits-all, mandatory buy-in regime is expected to have a significant detrimental impact on bond market liquidity and pricing; something that is highlighted in ICMA's 2019 CSDR mandatory buy-in market impact study.

- **Consolidated tape (Action 14)**

ICMA welcomes the fact that the EC has carefully considered the potential benefits of an EU post-trade consolidated tape as a tool for reliable access to consolidated data. However, Action 14 refers to the establishment of a consolidated tape for equity and equity-like financial instruments only. **This seems to be a missed opportunity as a consolidated tape *for bonds* could help support confidence and efficiency in the EU bond market** (alongside many other potential benefits). Furthermore, this would be an important development in encouraging retail investment in EU financial markets, which is a goal of the new Action Plan. ICMA also draws attention to the workable solutions for an EU bond consolidated tape that it put forward to the EC in April 2020[2].

- **Cross-border provision of settlement services in the EU: Review of CSDR (Action 13)**

From a repo and collateral management perspective, **the fragmented post-trade environment in Europe has been a long-standing concern**. While important steps have been taken, in particular with the launch of TARGET2-Securities and the associated harmonisation agenda driven by the European Central Bank, there are still significant frictions in place which prevent collateral from flowing freely across borders. ICMA's European Repo and Collateral Council (ERCC) actively contributed to the 2017 Report by the European Post-Trade Forum (EPTF) established by the EC, which attempted to identify remaining barriers in this area and put forward suggested solutions. **Most of these barriers still persist, including a number of issues that require follow-up action by the public sector.** ICMA encourages the EC to take these into consideration in the context of its work under Action 13. In the meantime, the ERCC is actively working with members and other key stakeholders, including the relevant infrastructure providers, to identify remaining inefficiencies and bottlenecks in the settlement space.

As noted above, ICMA also considers it to be very important that any review of CSDR includes a reconsideration of the mandatory buy-in regime in order to facilitate deep and liquid markets in bonds.

- **European Single Access Point (Action 1)**

ICMA recognises the advantages of an EU-wide digital access platform for companies' public financial and non-financial documents, if appropriate filtering functionality is provided. ICMA also welcomes the EC's recognition that the new European Single Access Point (ESAP) should be introduced in a manner that will, to the greatest extent possible, avoid adding to companies' reporting burdens. The EC also states that "all information will be provided in comparable digital formats". The precise

[2] See also *Transparency and Liquidity in the European Bond Markets, An ICMA Discussion Paper*, ICMA, September 2020.

meaning and possible impact of this is not yet clear, but ICMA highlights the **need to avoid (i) inappropriate standardisation requirements** (which can restrict borrower flexibility to access capital market funding) **and (ii) borrowers needing to have coding resources** (which can significantly increase the cost and so reduce the attractiveness of borrowers accessing capital market funding).

Final Considerations

Many of the concerns mentioned above were raised previously by ICMA in its preliminary thoughts and response to the HLF's Final Report. ICMA trusts that, while some of these key aspects have not been expressly addressed in the new Action Plan, the EC and co-legislators still have the opportunity to give them due consideration as part of the round of assessments and legislative proposals that will follow the publication of the Action Plan.

Moreover, ICMA is mindful of the fact that a few recommendations proposed by the HLF have not been incorporated into the new CMU Action Plan and might be pursued in dedicated files instead, such as new EC strategies in the context of **Sustainable Finance** and **Digital Finance**. ICMA will continue to monitor and engage on these and other files that are of interest to its members as the new Action Plan unfolds.

Further information on ICMA's work in the area of CMU can be found on our webpage and Quarterly Report.

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