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DG FISMA
European Commission
1049 Bruxelles/Brussel
Belgium

Re: Public consultation on the capital markets union mid-term review 2017

Dear Sir/Madam,

CFA Institute appreciates the opportunity to respond to this consultation on the capital markets union mid-term review. CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behaviour in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 140,000 members in 150 countries and territories, including 133,000 Chartered Financial Analyst® charterholders, and 147 member societies.

Please find below our comments on four sections of the consultation dealing with: improving access to public capital markets, encouraging long-term investment, fostering retail investment and innovation, and improving cross-border investment.

1. **Making it easier for companies to enter and raise capital on public markets**

General Comments:

CFA Institute supports the goal of improving access to capital markets for both companies and investors. While many regulatory initiatives to this end are well intended, they often do not achieve their objectives, particularly when they end up raising barriers to competition or reducing consumer choice. Investor protection is a key part of CFA Institute's mission, but to avoid regulatory overreach we believe policies and regulations should be proportional to the materiality of the product or service and its potential benefit to the investor. Further, investors must take responsibility for their actions as well. For this reason, CFA Institute is supportive of efforts to improve financial literacy across the EU through initiatives such as the European Platform for Financial Education[1]. An important enabler of financial literacy is well-designed information disclosure, which we are pleased to see is a focus of the CMU.

Prospectus Regulation

One of the first pieces of the CMU jigsaw, the updating of the Prospective Directive and the creation of the Prospectus Regulation, is an attempt at reducing the burdens of listing for SME firms, supporting the aim to facilitate capital formation and increase market-based finance in Europe. The prospectus regulation seeks to simplify the regime and harmonize disclosure standards for public securities issuances; objectives that CFA Institute supports. A well-calibrated prospectus regime has the potential to improve the quality and consistency of information to investors, as well as reducing administrative

[1] For more information - http://www.ebf.eu/european-platform-for-financial-education-launched/

burdens for issuers. To inform the development and design of the prospectus framework, we have conducted a study on the summary prospectus that will be released in April 2017. A preliminary and confidential draft is attached to this response. We believe that initiatives like simplifying the summary prospectus have an important role to play in making it easier for companies to enter and raise capital on public markets, while not threatening investor protections or watering-down information disclosure standards.

While retail consumer behaviour that does not conform to economic rationality has been well documented, there is also growing evidence that professional financial intermediaries and investors also suffer from irrationalities and behavioural biases. Information overload is a common complaint related to disclosure regimes. Increased disclosure requirements can backfire when investors are not able to absorb the quantity of information presented, which can be thought of as increasing transaction costs (search costs) for the market participant. Another complaint is the use of boilerplate disclosure; this results in the presentation of generic information that satisfies compliance considerations, but lacks pertinent information concerning the company, security, or product.

One example of disclosure that has been criticized involves summaries of prospectuses under the structure of the summary prospectus document; this is a key concern for investment management professionals as it is a critical component of the investment decision-making process. However, prospectuses are anecdotally known to be very long with large sections of boilerplate that tend to limit the ability of even professional investors to comprehend the contents. For this reason, prospectus summaries typically seek to highlight the key areas of interest.

However, even these summaries can often run up to dozens of pages and likely do not function as intended — as a concise summary of the full prospectus. Currently, the prospectus directive prescribes a maximum summary length of 15 pages, or 7% of the prospectus length, whichever is longer. This is scheduled to be replaced under the prospectus regulation with a fixed page limit of around seven pages. This change is consistent with one of the main prescriptions of behavioural insights: simplification. However, while a fixed page limit will force some degree of simplification by default, there are further behavioural insights that could be applied to improve disclosure quality.

In our study, we propose a template for the page-limited summary prospectus that is informed by behavioural insights documented in the literature. The key insights considered are the importance of:

- standardisation to improve comparability;
- increased use of images to improve comprehension;
- emphasizing salience in the design; and
- designing for comprehension on monitors and portable devices.

CFA Institute believes incorporating the design features presented in our template would contribute to less burdensome and more comprehensible security issuance, thereby improving the functioning of capital markets.

Taxation Issues

To further facilitate capital formation on public markets, the Commission should consider encouraging Member States to implement an advantageous tax regime for public equity and debt issuance, with a bias towards equity. Currently private debt can be secured by collateral, while public issuances are

unsecured, leading the former to have a pricing advantage that could be ameliorated using favourable tax treatment for public issuance.

MAR/MAD Issues

CFA Institute would be in favour of a further clarification of what “proportionate” sanctions mean in the context of the market abuse framework. The application of “proportionate” sanctions implies that the specifics of each Member State’s markets and the size of businesses in relative and absolute terms should be taken into account when determining what level of sanctions to apply.

We believe that further guidance, or a common base, to local authorities on the application of the proportionate sanctions could help to ensure consistency throughout the European Union. This in turn, should help create a level playing field and ensure similar treatment for firms of a similar size across jurisdictions. This, we believe, will benefit interest in, and access to, public capital markets across the EU.

2. **Investing for the long-term, infrastructure and sustainable investment**

At present, we believe insufficient emphasis is afforded to corporate governance throughout the CMU agenda. Corporate governance is the system by which decision-making, control, and accountability are exercised in companies; it therefore plays a central role in the functioning of capital markets because it enables shareholders to exercise their ownership rights and exert influence over company management, supporting corporate accountability and transparency. Accordingly, corporate governance is a central component of well-functioning capital markets; yet it is notably absent from the CMU agenda. The CMU mid-term review provides an opportune moment to address this deficiency.

Corporate governance is exercised through the capital markets, and is central to the aim of supporting long term and sustainable investment. Public companies are important economic vehicles, putting investors’ capital to use by deploying corporate resources toward productive enterprise. If these companies are poorly managed or have weak governance standards, they will not deliver the long-term returns that shareholders require, nor will they meet the needs and expectations of workers, consumers, and society. Investors may be reluctant to allocate capital to such companies, thereby impacting capital formation, economic growth and productivity.

Over the past fifteen years, European corporate governance policy has comprised a series of initiatives designed to enhance corporate transparency, strengthen the protection of shareholder rights, enhance board effectiveness, facilitate shareholder engagement with company management, and encourage investor stewardship. Many of these initiatives emphasise disclosure and are (appropriately) based on “comply-or-explain” mechanisms, as opposed to hard law.

These policy initiatives have been generally welcomed by investors and have helped to create common minimum governance standards throughout Europe. Yet these initiatives are somewhat disparate, and lack a unifying framework. The CMU initiative provides the possibility to create a unifying vision and framework for corporate governance. In this context, we emphasise the importance of ensuring coherence and joined up thinking between the governance mandates of DG JUST and DG FISMA.

One of the most pressing practical governance concerns of investors is the protection of minority shareholder rights, particularly in the context of controlled companies. Measures needed to uphold minority investor protections include:

- Promoting better board accountability to minority shareholders, perhaps through more robust independence standards, a greater role in "hiring and firing" the board members, and stronger board diversity
- Continuing to press for rights relating to material related-party transaction votes (for example, as initially proposed under SRD II)
- Not promoting differential ownership rights and dual class share structures, which undermine open accountability.

Regulators should continue to work with market participants to fix the "plumbing" of cross-border proxy voting to ensure that shareholders are able to vote in an informed way and that all legitimately owned and cast votes by shareholders are formally counted and ultimately confirmable to the voting shareholder. This would be an important development to support and underpin cross-border investment and the effective exercise of governance.

Policymakers should also consider developing a guidance statement for company boards and institutional investors that articulates stewardship expectations stemming from SRD II. This guidance should reflect sensitivity to the complexities of large asset managers that deal with widely diversified holdings, multiple mandates, and differing investment strategies. It might also establish the expectation that companies have a role to play in engaging with investors to achieve the broader goals of investor stewardship.

Finally, The European Commission should encourage strong monitoring mechanisms in individual European member states to ensure that companies and investors either adhere to governance and stewardship code requirements, or provide a credible explanation. Different monitoring systems exist in some European markets, and the Commission should at least seek to ensure that individual member states have an appropriate mechanism to give substance to soft law.

To further develop monitoring mechanisms, the Commission could consider setting up an expert group on corporate governance comprising supervisory authorities, institutional investors, and representatives of companies to assess the effectiveness of corporate governance frameworks across the EU. This would inform best practice and assess the level of compliance with governance standards.

The Commission may also consider supporting the development of a governance 'scorecard' that would allow companies to benchmark themselves against European best practice, and monitor progress towards best practice standards. An example of such an approach can be observed in India where a corporate governance scorecard has been designed by the Bombay Stock Exchange and the International Finance Corporation. This scorecard has been developed on the basis of the OECD principles on shareholder rights, the role of stakeholders, disclosure requirements, and responsibilities of the Board.

3. Fostering Retail Investment and Innovation

Fintech Survey

In answering this question, we wish to draw the Commission's attention to the potential of robo-advisers in fostering retail investment, and to raise the experience of marketplace lenders in the UK as a cautionary example of not allowing regulations to be circumvented by technology.

The concerns of the Commission in encouraging retail investment are consistent with the conclusions of the financial advice market review (FAMR) published by the U.K. Financial Conduct Authority and the Treasury in March 2016. The FAMR noted that steps needed to be taken to make the provision of

advice to mass market investors more cost-effective, and included a proposal to help firms bring mass-market automated advice models to market more quickly.

Many commentators argue that robo advisers could fill an "advice gap" that has opened in consumer segments that wish to avoid high up-front fees for financial advice. This situation is particularly relevant in the U.K. following the ban on commission-based advice in favour of fee-based services under the Retail Distribution Review, which was implemented in 2012 (and which will become more widespread in the EU following the implementation of MiFID II and the inducements rules it prescribes). These automated technologies are already significantly impacting the provision of retail financial advice.

Robo-advisers typically provide relatively basic investment advice, dividend reinvestment, and tax loss harvesting at very low cost through an internet portal. Examples of independent robo-advisers include (among others) Nutmeg in the UK, and Betterment and Wealthfront in the United States. We believe these US firms are the largest robo-advisers with assets under management (AUM) of around $3 billion each. There are also so-called hybrid advisers which offer both robo-advice and traditional asset management advice through human interaction. Examples of hybrid advisers are Personal Capital and FutureAdvisor.

To understand the impact of automation in financial advice, CFA Institute conducted a member survey in February-March 2016. We received 775 responses from our survey pool (a high response rate of 20%) and the results were published in April 2016.

The survey found that over 70% of respondents think mass affluent investors will be positively affected by automated financial advice tools, in the form of reduced costs, improved access to advice, and improved product choices. This finding is consistent with the anecdotal observation of robo-advisers targeting the lower-end, passive investment market.

At the same time, respondents found it unlikely that automated financial advice tools will gain traction with ultra-high net worth and institutional investors, with 71% and 63% of respondents, respectively, suggesting that these groups would not be affected by automated advice. The implication is that the tailored nature of financial advice to these market segments is not as easily amenable to standardized automation tools typically provided by robo-advisers. These groups of investors, with large portfolios and potentially diverse and complex investment needs, are likely to continue to favour personalised, human advice.

The concern heard most often from fintech companies is about the need for an accommodative regulatory regime for firms that do not have the scale or expertise to manage regulations to the same extent as incumbent firms. Regulators are in a difficult position because fintech firms usually deal with retail clients or investors, which must typically be afforded the highest level of consumer protections.

Thus, regulators often consider existing regulations to be absolutely necessary for fintech firms to comply with, while fintech firms often consider existing regulations to be too onerous. One interesting approach observed in the United Kingdom (UK), and being followed in other parts of the world such as Singapore and the United Arab Emirates, is the concept of a regulatory sandbox. As part of its Project Innovate2, the UK's Financial Conduct Authority (FCA) has proposed the creation of a 'safe space' they

[2] More information can be found at: https://www.the-fca.org.uk/firms/project-innovate-innovation-hub/regulatory-sandbox

describe as a regulatory sandbox, where fintech businesses can test products, services and business models in a live environment but without the normal regulatory consequences.

Initiatives like this raise the question of whether to pursue the "same risk, same regulation" approach or whether to regulate on a "same activity/same regulation" basis (the sandbox principle). In the past year, developments in the peer-to-peer lending industry have brought this issue to a head. Specifically, many if not all P2Ps increasingly resemble traditional banks; they have institutional funding, bundled investments resembling collective investment schemes, provision accounts implying deposit guarantees, and early/immediate redemption implying deposit-like characteristics. This has generated a distinct pause in the FCA's enthusiasm for approving start-ups in this field.

CFA Institute believes this P2P experience in the UK is a good example of why regulation in the fintech space should develop on a same risk, same regulation basis. Technology may allow a given activity to be potentially performed in a different way (e.g. in a disintermediated form) but technology cannot change the fundamental financial risks involved (e.g. credit risk, default risk). For this reason, CFA Institute has advocated on several occasions for regulators to pursue a technology-agnostic approach to regulation – it is the substance of the risk that matters, rather than the channel through which it could materialise.

In the specific case of robo-advisers, we think a key issue is to ensure the suitability of financial advice given that client onboarding happens through concise online surveys rather than face-to-face meetings with financial advisers.

Supervisory convergence

One consequence of the current regulatory and supervisory architecture is that while there are common rules (e.g. through the "single rulebook"), supervision and enforcement practices differ among member states. Such differences raise the possibility of regulatory arbitrage where some companies register in low supervision countries and then take advantage of passporting to offer their services across the EU, thereby potentially circumventing proper regulatory scrutiny. This kind of behaviour erodes public confidence in markets and, therefore, may hinder the objective of fostering retail investment.

4. Facilitating cross-border investment

In October 2016, CFA Institute answered a call for evidence on cross-border distribution of funds across the EU. We believe many of the issues discussed in that letter are directly applicable to the question of facilitating cross-border investment in general. By improving the cross-border distribution of funds, a more liquid capital market is created that should foster cross-border investment.

Feedback from our members suggests that tax rules within the EU are the main hindrance to direct distribution of funds. Specifically, the tax system within the EU is not harmonised among member states. This means that the fund provider must prepare tax reporting based on local rules and lacks a unified approach to creating the legal fund structure. For example, in different member states, a corporation (e.g. SICAV) or a unit trust (e.g. FCP) might be more or less appropriate for certain clients. However, the replication of funds in different structures is costly. Our feedback is that double taxation treaties are not the main issue regarding tax barriers; rather, it is differences in the legal tax structures of fund types across Member States that create complexity.

Regarding the barriers to investment by EU citizens in funds domiciled in another Member State our feedback is as follows. First, we must assume that investors typically have a "home bias" as they generally know the sponsor (at least by name) and share the same language/culture thereby creating

a sense of confidence or at least comfort in the investment being pursued. Second, from a tax perspective, the optimal investment vehicle may come under a specific legal structure regarding withholding tax or stamp duty that exists in the home state and may not exist in another Member State.

Finally, there are potential legal constraints on top of the issues described above due to the specificities of local regulations, or in the case of pension schemes, investment limitations or restrictions as a matter of internal policy (e.g. according to product range, share classes, and other factors constraining the selection of funds within the scheme). In the case of segregated accounts, trade-offs often need to be made and these may prevent investment in platforms domiciled in another member state, or at least only a few domiciles / fund structures may be eligible.

Despite Europe-wide regulations, fund distribution is still subject to various country-specific barriers, as well as goldplating by individual member states who are introducing extra rules or restrictions. Thus, it is often complex and expensive for fund managers to offer their products across the European community. This is an impediment to free flow of capital routed via managed funds, both for institutional and retail investors.

Finally, we also wish to reiterate our comments on corporate governance noted in section 2 of our response. Corporate governance plays a central role in the functioning of capital markets and supports the formation of capital, including in a cross-border context. The CMU initiative provides the possibility to create a unifying vision and framework for corporate governance.

In the context of facilitating cross-border investment, we reiterate the need to examine the plumbing of cross-border proxy voting, to ensure that all shareholders, irrespective of domicile, can be identified and have their votes cast and counted. Differences in local laws and governance frameworks can obfuscate or hinder the exercise of voting on corporate affairs in a cross-border context; in turn, this may create barriers to investment, hinder the deepening of our capital markets, and discourage the dispersion of ownership in Europe.

Concluding Remarks

We welcome this opportunity to comment on the CMU mid-term review. Please do not hesitate to contact us should you wish further elaboration of the points raised.

Yours faithfully,

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