European Commission
Via Website: ec.europa.eu/eusurvey/runner/capital-markets-union-2015

13 May, 2015

Dear Sirs,

Re: Consultation on Green Paper Capital Markets Union

The International Corporate Governance Network (ICGN) welcomes the opportunity to comment on the European Commission's Green Paper on Capital Markets Union (CMU).

ICGN was founded 20 years ago and is an investor-led membership organisation of more than 600 individuals based in over 50 countries from around the world. Our mission is to inspire and promote effective standards of corporate governance to support the sustainable value creation of companies and to advance efficient markets and economies world-wide. Our members represent institutional investors with global assets under management in excess of US$26 trillion. Accordingly, ICGN's members offer a source of practical knowledge and experience with regard to governance and investment issues. For more information on the ICGN, please visit www.icgn.org.

The membership of ICGN has vetted and adopted a series of governance principles and best practice documents that give guidance for achieving high quality corporate governance standards by companies and responsible standards for investment by institutional investors in Europe and other jurisdictions globally. The ICGN Global Governance Principles and the ICGN Statement of Principles for Institutional Investor Responsibilities are particularly relevant in our submission to this consultation. In our response to the Green Paper we will make some general comments and respond to those questions where the ICGN's policies and perspectives may prove useful for your deliberations. We highlight the most relevant elements of ICGN guidance in this response, though we also encourage you to review these documents as a whole.

General comments

ICGN is highly supportive of the European Commission´s efforts to create a capital markets union. In particular, ICGN believes that institutional investors should be incentivized to invest directly in public equity markets which provide simple, effective and liquid long term direct investment products or opportunities. It is of utmost importance that the funding of companies – listed and non-listed – will find a balance between financing through the banking industry and the financial market.

Making the CMU work for the real economy and society requires a renewed focus on the three primary functions of financial markets which are essential:

- Efficient allocation of resources from providers of capital to the users of capital - the asset allocation function;

- Efficient financial intermediation – that is the efficient transforming of deposits into loans for firms and households; and
- Effective and efficient risk management – the insurance function which allows households and firms to protect themselves against economic risks.

The CMU initiative should involve all types of investors and promote financial markets that are safe and resilient, efficient, fair, transparent, well-regulated and easily accessible to (individual) investors[1]. While addressing some of the specific questions in your consultation, we would like to make some overarching comments about a few important themes that have been identified:

- **SMEs.** The Green Paper is ambitious in terms of the relevance to the wide range of users it wishes to address. The Green Paper sets at its focus the area of SMEs as a priority. However, there are substantial differences in the character and needs of the range of SMEs in the European economy. This to a great extent reflects the definition of SMEs in terms of size and state of development.

  ICGN supports attempts to develop more financing opportunities for small and medium sized enterprises (SMEs). SMEs contribute both to economic growth and job creation, and they can also represent important opportunities for investors. It is important that the development of SMEs is not hampered by unduly burdensome regulation and governance requirements. At the same time, however, the opportunities presented to SMEs for capital market funding also come with responsibilities for SMEs to maintain strong governance standards if they are to be deemed as acceptable for investment by pension funds and retail investors.

  ICGN appreciates that governance standards for SMEs may require greater flexibility relative to larger, more established companies. But while SMEs need to develop governance standards and structures that are appropriate to the company's own stage of development, basic standards of good governance and shareholder protection must be maintained and should not be compromised—otherwise access to finance will be limited. As the SME matures in its own development institutional investors will expect SMEs to adopt appropriate governance standards that are appropriate with the individual company's stage of development.

- **Bonds.** The Green Paper rightly identifies the use of public debt markets to increase financing sources to companies. The ICGN is supportive of expanding the corporate debt issuer base in European capital markets, along the similar proviso relating to SMEs that debt issuers maintain acceptable credit and quality standards for inclusion in pension funds and retail investment funds. It is important to stress that creditors, like equity investors,

[1] «*It makes no sense to create a fully integrated market for professional investors and maintain a separate less efficient and less integrated market for retail investors*" – Steven Maijoor, chair of ESMA, December 2014

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also look for companies to have good corporate governance standards—particularly as they bear the residual risk of the company in the event of failure. Particularly for companies that are public issuers of both debt and equity, is important for companies to have clear financial policies that enable both creditors and shareholders to understand how the company is managing its financial structure and the risk trade-offs between creditors and shareholders.

- **Sustainability and sustainable investment products**. The Green Paper addresses how the EU can facilitate more investment that takes into account ESG (environmental, social, governance) standards and sustainability issues more broadly. This includes the use of "green bonds" to attract financing of this nature. The ICGN recognises that there may be an appetite among certain investors for financial products that are explicitly branded as "ESG" or "green". However the ICGN believes the EU's main focus should be less on promoting financial products of this nature as much as promoting stronger ESG and sustainability performance by all companies. Many investors are likely to attach a greater priority to investing in conventional debt and equity securities of companies that that themselves have good ESG standards, rather than seek out specific investments that may carry a green branding for marketing purposes. In other words, green companies trump green bonds.

3. Priorities for early action

2. *What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?*

ICGN supports further steps around the availability and standardisation of SME credit information. Information that is publicly available in the case of SMEs is often limited, while the risks associated with these investments are often higher that in the case of other listed enterprises. There is significant room for improvement in the ease of access to credit data. A requirement to file statutory financial reports without any delay in a single, freely accessible and easily usable European database would help investors and trade counterparties to look beyond their national barriers. The scope for widening the investor base beyond trade creditors, banks and private equity is highly related to the availability of high quality IFRS financial reports.

CMU Questionnaire: 4.1 Improving access to finance

5. *What further measures could help to increase access to funding and channelling of funds to those who need them?*

Public equity financing is currently disincentivised when compared to debt financing. ICGN refers to the IPO task report The European IPO Taskforce Report *Rebuilding IPOs in Europe: Creating jobs and growth in European capital markets* for measures that could be taken to create an equity culture in Europe. This is of great importance for SMEs seeking financing as well as for retail and institutional investors to whom public equity markets, including IPOs, market, provide simple, effective and liquid long term direct investment products.

ICGN would strongly support the EU develop new initiatives that would help lift legal barriers in all Member States for non-bank institutional investors that aim to provide loans to corporates.

7. *Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environment, Social and Governance) investment, including green bonds, other than supporting the development of guidelines by the market?*

ICGN believes that action by EU is not needed.

Institutional investors are increasingly looking for investment opportunities that combine financial return with positive social and environmental impact. This development is reflected in the recent growth of the market for green bonds. This growth however comes with a challenge: issuers need to ensure the quality of green bonds to gain and maintain trust from investors.

This requires standardisation of guidelines regarding transparency and disclosure on green bonds, including guidance for evaluating and reporting on the environmental impact. This process of standardisation is currently driven and ultimately should be driven by the market itself. The Green Bond Principles (GBP), initiated by the International Capital Market Association and supported by, amongst others, the World Bank and the European Investment Bank, provide issuers with a framework promoting clear definitions and transparency.

The Climate Bond Initiative (CBI) currently works on a reporting framework to provide buyers of green bonds with clear information on the content of the bond, and related environmental effects. This could eventually lead to a system of certifications indicating the level of environmental impact associated with the bond. And specifically for the project finance market a standard ESG policy already exists globally in the form of the Equator Principles, which have been adopted by over 80 financial institutions.

Since the GBP, as well as the CBI and the Equator Principles, are currently developing and increasingly gaining support in the market, ICGN currently recommends that further efforts are not necessary in developing (additional) guidelines regarding ESG investment or green bonds.

CMU Questionnaire: 4.2 Developing and diversifying the supply of funding

10. What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

ICGN would like to express caution for putting too much pressure on institutional investors to invest in a broader range of assets. Investors primarily have a fiduciary duty to generate sufficient return given the risk and to protect the invested property. Too much governmental or political pressure could result in allocation of funds to investments that are inappropriate for the client and the investment mandate.

Furthermore, as stated as a response to question 5, ICGN believes that public equity investments by institutional investors should be facilitated. Institutional investors are currently incentivized by international/European as well as national restrictions on investments in IPO and public equity in general to invest in bonds which are not attractive to them (especially considering the current market conditions). The allocation of funds to equity in Europe is therefore rather limited in comparison with other markets. ICGN refers to The European IPO Taskforce Report *Rebuilding IPOs in Europe: Creating jobs and growth in European capital markets* for recommendations on how institutional investment in public equity markets can be promoted.

In general, prudential rules and supervision currently discourage institutional investors from investing in long-term projects that can contribute to the real economy (and which also generate a high return for these investors). If the European Commission would like to promote these kinds of investments, it should adopt flexibility in its risk approach regarding these kinds of illiquid assets. Public equity markets, including IPO markets, on the other hand, provide simple, effective and liquid alternatives to bonds.

21. Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?

Further integration of European capital markets should ensure the necessary scaling that benefits markets like China and Asia, Latin America and the US. ICGN furthermore supports a more active EU international investment policy focusing on investment liberalisation and investment protection. European markets can furthermore become more attractive by increasing investor protection levels and governance principles across Europe.

Unfortunately we cite recent legislative developments in France, Italy and at the EU level that we believe work against shareholder rights and the attractiveness of European markets. Specifically, we cite the introduction of differential ownership rights, including multiple voting rights, under the auspices of rewarding long-term shareholders. We believe this is a fundamentally flawed tactic that can lead to entrenchment of vested interests and to a disproportionate influence by the controlling shareholder.

Regarding the initiative for a CMU in 2019, ICGN takes the opportunity to suggest themes for a revision of the Transparency Directive:

- Harmonisation of the thresholds to notify major holdings in listed companies – currently some investors have to look into the articles of association of a company to find out what the first notification threshold is. Also, the methods of calculation, language and ways of notification should be fully harmonised.
- The notifications on major shareholdings should be collected in a European central register. This would facilitate a more rapid analysis of the shareholder structure for potential investors in a European listed company.
- More clarity on what constitutes ‘acting in concert’ in order to stimulate coordination of governance efforts by shareholders.

22. What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?

ICGN furthermore supports a more active EU international investment policy focusing on investment liberalisation and investment protection, thereby opening up markets for all European retail and institutional investors, not only those from a specific Member State. It is important that investment liberalisation does not go at the expense of investor protection.

Furthermore, the European Commission should liaise with the SEC and other relevant US authorities (e.g. the PCAOB) with respect to transparency and financial services regulation, in order to see if equivalence is maintained and the international level playing field remains intact. Equivalent reporting and financial services rules would bring wider benefits to all companies and stakeholders and would fulfil the objective of achieving common global standards in the area of financial services. The real economy would directly benefit from a higher level of transparency, cutting reporting and regulation costs for companies and investors and higher standards of governance in companies.

CMU Questionnaire: 4.3 Improving market effectiveness – intermediaries, infrastructures and the broader legal framework

23. Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

- For politicians, policy makers, industry and media to refer to “all-tradable” indices instead of blue chip ones when they communicate on “equity markets”.
- Eliminate barriers to shareholder engagement.
- Improve the summary prospectus for shares and bonds by making it as user-friendly, formatted, standardized, short and comparable as the KID for funds and the future KID for PRIIPs and possible “PBS” for pension fund participants (IORP review proposal from the EC) and KID for personal pension products (current EIOPA work for the EC).
- Reduce market fragmentation, “dark” and OTC trading; impose same transparency requirements to the new marker venues.

Any resumption of securitization must be highly standardized and kept as simple as possible; banks should keep significant “skin in the game”.

24. *In your view, are there areas where the single rulebook remains insufficiently developed?*

Reference is made to our answer to question 21. In particular, a uniform interpretation of what constitutes ‘acting in concert’ should be added to the single rulebook.

25. *Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a Capital Markets Union?*

ICGN believes it is of high importance that the same level of supervision is applicable in all 28 Member States. A perfect example is the current implementation of new investor protection rules by ESMA. While MiFID/MiFID II harmonizes investor protection rules across Member States, it leaves ample room for interpretation and judgment by NCAs resulting in different levels of investor protection across the EU. In addition, the intensity of supervision is not the same across Member States due to different levels of resources and divergent prioritisation among supervisory issues.

28. *What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?*

One of the main obstacles to a real integrated European Capital Markets Union is the absence of an effective set of EU rules for minority shareholder protection. A minimum, pan-European set of rights for shareholders to hold boards of companies accountable to shareholders is required. This minimum set of rights should comprise at least – in addition to the current set of rights encompassed by the Shareholder Rights Directive:

(i) The right for shareholders to appoint, nominate and remove company directors.
(ii) The right for shareholders to approve fundamental corporate changes, initiated by the board, e.g. large acquisitions. Numerous studies show that many acquisitions destroy value for acquirer shareholders and that the losses from the worst performing deals are very large, also to society at large. Shareholder approval can block undesirable acquisitions, deter executives from initiating them, and give executives leverage to negotiate better acquisitions.
(iii) Shareholder approval of the use of anti-takeover devices that can be used by the company to frustrate or to block a hostile takeover attempt.

To conclude

ICGN is highly supportive of the European Commission´s efforts to create a Capital Markets Union. We are looking forward to a more competitive financial market and a

Capital Markets Union that contributes to the overarching goal of the European Commission for growth and jobs.

We hope these comments will be helpful. If you wish to discuss our comments further, please contact ICGN Policy Director George Dallas at george.dallas@icgn.org.

Yours truly,

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