**Re: BlackRock response to the European Commission’s consultation on the mid-term review of the Capital Markets Union**

BlackRock is pleased to respond to the Commission’s consultation on the mid-term review of the Capital Markets Union (CMU) project. We have supported the aims of this project since its inception, and continue to believe that promoting the growth and increased efficiency of Europe’s capital markets will help build a sound funding base for the European economy in the future.

We have written previously on the CMU and provided input to the Commission on the initial CMU Roadmap:

- **ViewPoint: The European Capital Markets Union: An Investor Perspective**

- **Response to the Green paper “Building a Capital Markets Union**

BlackRock has provided feedback to the responses of a number of trade associations of which we are members – including the European Fund and Asset Management Association (EFAMA), and International Capital Markets Association (ICMA) – and have tried to focus our remarks to this consultation on specific areas where we feel we can provide feedback to the Commission above and beyond what these associations have provided.

The content to the specific questions below was submitted online in the European Commission’s questionnaire format. The following content does not appear in the exact order of the questionnaire.

**Introduction and Executive Summary**

BlackRock continues to be supportive of the aims of the CMU: to promote more market-based finance, and to break down barriers to the cross-border flow of capital in Europe. The project is set against a background of change as capital markets are experiencing a number of structural changes as the post-crisis regulatory reforms and business pressures are changing the way many specific markets are structured. The post-Basel banking sector will fundamentally change how capital is intermediated in many markets; this is in many ways an intended, and positive, consequence of recent reforms.

Against at times challenging political forces in Europe, the CMU can look like an incredibly difficult project. But developing a stronger, more unified, yet open, capital market will serve Europe well in the longer term – and indeed the economic benefits of achieving the CMU goals may well prove longer-lived than these forces of political uncertainty.

The CMU remains incredibly important to Europe’s economic future, and indeed can help deliver better financial well-being for Europe’s citizens. Europe remains largely reliant on bank finance, and hence, particularly sensitive to the economic effects of pressures on the banking sector. To be clear, BlackRock continues to believe that bank finance will remain the most important source of funding for many European companies and projects for a variety of structural reasons – but the development of more robust capital markets can and should play a valuable role in complementing and augmenting bank finance.
This can be achieved by building up a regulatory framework at the EU and individual Member State level that: removes barriers to the flow of capital both globally and cross-border within Europe; supports the growth of non-bank sources of funding; and more broadly, puts end investor interests at the heart of rules and policy – as it is they who will put the capital into the Capital Markets Union.

Our key recommendations outlined in this paper are:

1) Focus on enabling a larger investor base for early stage and pre-IPO equity investment: this means looking at structural barriers to a greater allocation of capital towards these assets classes (e.g. Solvency II for insurers or national rules for pension funds), and also ensuring that investment vehicles, such as ELTIFs are viable and attractive to these investors.

2) Ensure final EU securitisation framework enables, rather than inhibits, capital market investors’ ability to support bank lending. This includes ensuring that Asset Backed Commercial Paper (ABCP) rules recognise the structural differences between securitisation and ABCP programmes and are appropriately tailored.

3) Look at sustainable finance holistically: promoting specific products (e.g. Green Bonds) can be important, but it will be more impactful to ensure there is a framework in place that encourages asset owners to incorporate the concept of sustainability into their broader investment strategies and gives them the metrics and information to do this effectively.

4) Encourage greater take up of capital market investment by retail savers in Europe by addressing the financial advice gap. This will not only provide more capital to be intermediated to the economy, but will also deliver better financial outcomes for individuals, and truly fulfil the aim that the Capital Markets Union creates a better link between European savers and the European economy.

5) Ensure that the regulatory framework for public capital markets reflects the market structure and realities of today – this is especially important for corporate bonds markets and repo markets – to ensure that the markets function optimally for investors and issuers. In addition, ensure that the regulatory framework protects the capital of end investors throughout the process of their capital being invested, especially in the clearing process.

As an overarching theme, we believe that regulation that puts protecting and promoting investor interest as a core aim will be the most important driver of success of the CMU.

Pre-IPO and early stage equity finance

We support the focus of the Commission on looking at early stage finance. In our experience, the European Fund for Strategic Investments (EFSI) has played a positive role in the SME funding space since its inception – but we do believe that there is greater potential for market-led growth of pre-IPO/ early stage equity.

Building a robust investor base

The key determinant of the growth of this market will be building up a dedicated long-term investor base who have the ability and appetite to invest in this space. Insurers and pension funds, due to the long-term nature of their liabilities, would be natural candidates to be encouraged into the market. This is to some extent a question of encouraging (or in some cases removing restrictions upon disincentives for) greater equity investment.
amongst these investors, but also providing the right vehicle that can allow them to invest in early stage companies as a subset of their equity portfolio.

We see an increased blurring of the lines between the role of different investor types (angel investors, venture capital, larger institutional investors, etc.) throughout the so-called ‘funding escalator’ with many traditionally early-stage investors staying involved in investments for longer, and many investors who may have traditionally only looked at funding companies at or near an IPO being involved much earlier.

In fitting with this trend, we have looked at the European Long Term Investment Fund (ELTIF) as a potential vehicle that would allow us the create a fund that would fund the different early stages of growth for a company in a single place. This would allow companies to work with a single funding partner throughout different stages, but also allow investors to access the early-stage finance in a single place as well. To the extent that further policy focus on the ELTIF can help make it more attractive to institutional investors like insurers and pension funds, we believe that this can be a useful development for the market.

Pooled funds investing in early-stage equity may face a significant challenge from the implementation of the OECD’s Base Erosion and Profit Shifting (BEPS) initiative. While we would emphasise that we fully support the aim of this project to address aggressive tax structuring by multinational companies, if a tailored solution is not found for investment funds – in particular to this case, those investing in the equity of unlisted companies (as these structures will not meet the anti-avoidance test necessary to access tax treaty relief) – the unintended consequence would be double taxation for cross-border investment. This is likely to have a chilling effect on ELTIFs, and likely investment activity in these asset classes overall.

BlackRock is supportive of a comprehensive European fund framework linked to a taxation regime that enables funds to continue to invest in assets on a cross-border basis, while delivering the necessary transparency and a fair outcome to both investors and tax authorities. At the global level, we believe implementing a ‘TRACE 2.0’ (a technology-focused successor to the OECD Treaty Relief and Compliance Enhancement programme) would give governments transparency and reduce the administrative barriers that currently affect the ability of investors to access the tax treaties to which they are entitled.

**Incentives for investment**

Structurally, we believe that the early stage investment market could be improved. It is not clear that existing regulation or policy creates any impediments, rather it is a case of building the right infrastructure and incentives that can help companies seeking investment find suitable investors to provide it.

In our experience, leadership at the national/local level has been a powerful catalyst for growing early stage investment: in particular, tax incentives both for companies raising equity capital and for investors who invest in a growth company (for example, the UK’s Enterprise Investment Scheme exempts investors from capital gains tax if they buy a share listed on the AIM market and hold it for at least 3 years, the 2017 Italian budget also includes tax incentives for the early-stage companies themselves to raise equity investment).

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1 For more detail, please see BlackRock’s submission to the OECD’s recent discussion draft on BEPS Action 6, as regards ‘non-CIVs’ (funds which invest in assets other than publicly traded securities): [https://www.blackrock.com/corporate/en-xx/literature/publication/beps-action-6-discussion-draft-nonciv-examples-oecd-020317.pdf](https://www.blackrock.com/corporate/en-xx/literature/publication/beps-action-6-discussion-draft-nonciv-examples-oecd-020317.pdf)
Currently, London’s AIM market is one of the most important sources of equity funding for growth companies all around Europe – we see merits in national governments and exchanges building up similar platforms elsewhere in Europe. The growth of more robust domestic growth markets would enable many domestic investors (such as state or occupational pension funds) to provide equity to national growth companies more easily than they might have if the company was only listed on AIM.

Finally, at the exchange level, we believe that the market would be better served by a relaxation of the listing rules for growth companies – in particular to allow introductions to potential investors earlier in the listing process.

We would also caution that equity finance is not the only funding concern for SMEs and growing companies – and as such, the policy debate around SME funding should not focus purely on equity finance. Many smaller companies will find sourcing working capital one of the greater challenges – meaning that providing options for them to access this type of capital (be it via banks or via capital markets) is also important to creating a strong European SME landscape. One such structure that provides meaningful funding to a wide range of European companies is Asset-Backed Commercial Paper (ABCP) programmes.

**ABCP**

ABCP provides over €100 billion of working capital annually to companies across Europe – including many unlisted and unrated companies, as well as SMEs.

We remain concerned that the European ABCP market could be significantly constrained by regulation. The recently-agreed Money Market Fund Regulation (MMFR) restricts the amount of funding that Money Market Funds (MMFs) can provide to ABCP programmes. MMFs are one of the largest investor bases for European ABCP due to the programmes’ strong credit quality and liquidity profiles. However, moving forward, MMFs will be limited to the amount of their portfolios they can allocate towards ABCP – part of which will be contingent on the final calibration of the rules for Simple, Transparent and Standardised (STS) ABCP still under consideration.

The STS rules by design fail to differentiate between the risks borne by the sponsor bank (to the underlying asset pools) and by the end-investor (to the bank sponsor and their ability to meet their liquidity and credit support commitments). As a result, without significant changes to the Commission proposal’s maturity restrictions on the types of assets that ABCP programmes can finance, it is unlikely many programmes will be able to meet the STS requirements which will enable MMFs to invest up to the maximum allowed under the MMFR.

However, we do not necessarily believe that the maturity restrictions are irrelevant to the capital relief (or non-relief) that the bank sponsor may get under the STS rules. To ensure a viable supply of STS ABCP under the current construction of the STS standards would require extending further the maturity limits which would likely meet with resistance. Extension is not necessary, however, as policymakers’ aims may be better achieved by de-linking the STS requirements that impact that sponsor bank’s capital (the transaction level requirements) from the STS requirements that impact the investor (the programme level requirements).

**Supporting bank capacity to finance the economy**

We agree with the assessment that bank finance is likely to remain one of the most relied-upon forms of finance in Europe, by both consumers and companies, for a variety of reasons. As such, the health of the European banking sector will continue to be of importance to the European economy. Topical issues such as what to do with Non-
Performing Loans (NPLs) in a number of European countries are of significant importance for the immediate future, but in the longer term, Europe will need a robust policy framework in place that allows capital markets to support bank finance as a means for channeling funding to the economy.

First and foremost, we should underline that we believe that the financial system is more resilient as a consequence of the numerous banking sector reforms enacted in Europe (and globally) since the financial crisis. While there is a very real debate to be had about the impact of these reforms on specific areas of banks’ businesses (and potential unintended consequences), we do not believe that a policy discussion around the ability of capital markets to support bank finance should centre on a rollback of prudential regulation. Rather, it should focus on an enhancement and optimisation of the regulatory framework for the specific mechanisms by which markets can help fund bank lending.

**NPLs**

We also agree with the Commission’s focus on resolving issues around Non-Performing Loans (NPLs) in the European banking sector. Particularly in specific countries, the high volume of NPLs inhibits confidence in the banking sector, and constrains banks’ abilities to originate new loans. But the problem is often complex and there are unlikely to be easy solutions.

While there is indeed interest amongst many specialist distressed debt investors in NPLs, the potential market is inhibited by information asymmetries and differences in the expected returns between buyers and sellers. Countries where there have been reasonably-successful resolutions of issues around NPLs have seen a development of asset servicers (both public and private) – who are able to build up the specialisation and data sets to be able to effectively restructure or resolve individual distressed loans. However, there are differences by countries and asset classes.

Other key impediments currently preventing increased resolution of NPL through sales are:

- For some countries, lengthy judicial proceedings, which can exceed 4 years, increase bid-ask spreads between buyers and sellers
- The current regulatory framework related to the impact of sales on the banks’ balance-sheet might reduce banks’ willingness to sell due to the consequences in terms of capital requirements (e.g. AIRB LGD impact on good book)

We believe that a true resolution to the issues around NPLs will require the leadership of governments and central banks – both in working with domestic banks to come up with NPL business plans, and potentially, in helping to build up asset servicing infrastructure to aid the development of a more functional market whereby investors can purchase some of NPL portfolios. At the same time, banks should continue to increase their operational effectiveness to identify and restructure remaining NPL portfolio not subject to sale. The continued segmentation of portfolios by banks should remain a key objective supported by regulators.

Finally, we believe that policymakers should be pragmatic about the likely end result of a private sector solution to NPL issues. The most attractive loans to distressed debt investors will be those priced attractively relative to the value of the collateral securing the loan. Liquidation of such collateral is a key component of the NPL resolution strategy which could include foreclosures if settlements or other resolution actions cannot be achieved. Looking at the NPL issue solely through the lens of bank balance sheet impairment – while important for economic well-being and the health of the respective national banking sector – may not capture the full picture of the problem. We believe that private investors have a strong role to play, but it must be balanced by public sector leadership.
Covered bonds

Covered bonds are often juxtaposed vis-à-vis securitisation as key mechanisms for providing capital market funding to support bank lending. We believe that the European covered bond market is an important asset class for many investors, and one where existing legal regimes in many countries are well-understood and highly functioning. Covered bonds as an asset class were significantly strengthened by their treatment under the Bank Recovery and Resolution Directive (BRRD) and the assurance that the bonds are not bail-in-able and the cover pools protected in a resolution.

Covered bonds are also one of the least expensive types of bond issuances for banks. Despite this, in the coming years, we expect issuance of new covered bonds to slow to some extent as banks are asked to focus on other areas of their capital structure. As the underlying assets in covered bonds are fully protected in a resolution process under the BRRD (a key feature of their attractiveness to investors), they are by definition not loss-absorbing assets. To meet new loss-absorbency standards, most banks will need to build up other parts of their capital structures, and we expect that covered bond issuance will slow (relatively speaking) as a result.

This should not be viewed by policymakers as a failure of the covered bond market in any way, but rather a consequence of new bank capital rules: and an intended (although potentially not expected) consequence as such. We do not believe that the European covered bond market requires any structural reforms – e.g. legal harmonisation of regimes, or the creation of a new pan-European legal regime; indeed, these could even introduce uncertainty into a well-functioning market in the worst case.

The European Covered Bond Council (ECBC) has proposed new industry-wide transparency standards, which BlackRock fully supports. We believe these standards can and should be introduced by the market.

Securitisation

By contrast, the European securitisation market currently suffers from an inconsistent and at times overly-punitive regulatory framework: which dampens investor interest in the asset class. We remain supportive of efforts to put the European securitisation market on a more stable regulatory footing, however the threats to the investor base by poorly calibrated final rules remains very real.

Securitisation is likely to remain the most efficient way for banks to be able to truly transfer assets of their balance sheet in order to free capital to originate new credit. The potential harm to the investor base should be cause for concern – once market conditions normalise, there will need to be a robust investor base to replace the ECB in the market. There is a real risk that the STS Securitisation Regulation (which covers more than just the STS designation, but also creates wide-reaching rules on all securitisations and for all investors in them), coupled with the failure to give insurers clarity about the next steps for risk weights under Solvency II, takes us further from this aim.

A poorly-calibrated rollout of the securitisation rules to UCITS investors (to whom the rules do not yet apply) could significantly hamper investor confidence and even create market disruptions if issues around appropriate grandfathering of legacy positions vis-à-vis the due diligence rules are not addressed.

Additionally, changes to existing risk retention rules for issuers could create confusion in the market – especially if the final rules are complicated or involve widely varying different headline levels of retention based on different methods. To give investors the confidence to underpin the market, the final rules need to provide regulatory certainty for the foreseeable future – not be embedded with confusing conditional reviews or optional
triggers that could change something as fundamental as risk retention (as investors risk their positions being non-compliant based on changes to the rules; even if the rules are effectively grandfathered in, the disruption will make legacy assets potentially liquidity-impaired as investors look for compliance with the most up-to-date rules).

Finally, we would highlight our response to a previous question regarding ABCP. ABCP is a critical tool for many banks, allowing them to optimize the way they fund many of their corporate clients by providing a framework by which they can access capital market funding with the benefit of the bank’s credit and liquidity support for their assets.

The future development of the market

Because of the punitive risk weights for securitisation relative to the underlying assets under Solvency II, we already see a growing number of insurers investing in individual mortgages directly (the risk weights for holding the underlying assets are lower than even the senior tranches of a mortgage-backed security\(^2\)). This trend may increase and become more appealing to a wider range of investors if the STS Securitisation rules undermine the attractiveness of the asset class.

We would suggest looking at individual bank loans – and would especially support efforts to bring greater harmonisation to the settlement times for these assets. A more standardised settlement time would allow individual bank loans (corporate or commercial credit) to trade more like securities – increasing their liquidity, and alleviating some potential concerns about some investors holding these assets rather than securitisations, but also allowing a wider range of investors into the asset class in future (e.g. UCITS funds). Similar efforts for mortgages could make mortgage portfolios easier to transfer from one investor to another – though we do not envisage a market when individual consumer credits trade frequently in the secondary market.

Developing a broader investor base for individual bank loans would have the added benefit of broadening the way in which markets can fund bank lending – not just purchasing loans after banks have originated them, but also participating in their origination on a syndicated basis. With a deeper investor base in the asset class and increased specialisation, we could foresee greater investor appetite to participate in bank lending in different forms – be it funding direct origination or buying bank-originated loans.

Sustainable Finance

We commend the Commission's focus on sustainable finance and infrastructure investment. BlackRock believes that climate change is a complex problem for policymakers, companies and for investors – and we are pleased to see the European Commission look at the issue from a holistic perspective with the creation of the High Level Expert Group on Sustainable Finance last year.

Capital markets will play an important role in providing funding to meet the challenges of climate change and to contribute towards the new technology and transitions that are likely to be needed to meet the aims of the COP21 agreement. The Capital Markets Union project has already provided some beneficial reforms for European infrastructure investment, and we believe that the CMU can be an effective vehicle to address other topical issues in sustainable finance moving forward.

We have observed that the debate around mobilising private capital to support climate goals can at times focus on specific products or asset classes, such as Green Bonds\(^3\), or stimulating greater infrastructure investment (especially in renewable energy). While these are important market segments, we believe that in order to make the most meaningful progress, policymakers should be looking at sustainability more widely and seeking to create an environment whereby investors are encouraged to take into account sustainability considerations when making investments across mainstream portfolios, and giving them the tools and information to make decisions in line with these considerations.

Creating an environment to foster sustainable finance

To provide better-adjusted incentives to foster investment in sustainable and infrastructure projects, it is important to start by understanding the investment profile of those who will provide capital, the asset owners\(^4\).

There is a growing amount of data demonstrating that companies which score highly on Environmental, Social and Governance (ESG) metrics provide more shareholder value in the medium to long term than those which do not. So to an extent, the market is already beginning to reward ESG behaviours; but to really catalyse a wider focus on the Environmental elements of ESG, improvements to the policy framework can be made.

It is important that asset owners have clarity on the expectations upon them when it comes to ESG considerations as part of their investment strategy. This is often done at the national level; for example, the French Energy Transitions Law requires investors to disclose how they take into account ESG considerations and to disclose the carbon impact of their investment portfolios. The recently-adopted Shareholder Rights Directive is also a step towards that aim by requiring institutional investors to publicly explain how they incentivise their asset managers to take into account non-financial criteria into their investment decisions. This creates an expectation that asset owners must at least consider how they will incorporate the concept of sustainability into their investment decisions – an important first step.

We believe that policymakers should focus on providing a framework for consistent and comprehensive disclosure standards by issuers, which will require that there is information to make investment decisions that can accurately incorporate ESG concerns.

Enhanced, meaningful disclosures are an important step towards building understanding of the impact on individual companies, sectors and investment strategies. Given climate risk is broad based, disclosure standards should be developed that are applicable to listed companies across each market and, ideally, that are globally consistent. To that end, we support the work of the Financial Stability Board’s Task Force for Climate Related Financial Disclosures (TCFD), on which BlackRock was represented, and plan to engage with companies to encourage them to consider using the TCFD reporting framework.

Meaningful and consistent disclosure will occur if and when the TCFD recommendations are followed through. As such, we welcome the decision of the FSB to extend the mandate of the Task Force until at least September 2018 to allow them to monitor the adoption of

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3 BlackRock sits on the Executive Committee of ICMA’s Green Bond Principles and support the input put forward by ICMA in their submission to this consultation.
4 By ‘asset owners’, we mean the owners of capital – institutions like insurance companies or pension funds, governments or individual savers – whether their capital is managed externally by an asset manager such as BlackRock or whether the asset owner invests it directly. Asset owners have a wide range of investment, regulatory, tax and accounting constraints – but each are responsible for broad asset allocation decisions, included for example, the extent to which sustainability factors should be a focal point for their investment portfolios.
their recommendations by companies and assess whether the disclosures respond to the informational needs of users.

Policymakers can play a role in encouraging issuers to use the new disclosure standards and to resolve any legal barriers that might prevent them from using them (for example potential liability or litigation risks associated with disclosure). We believe that the EU Non-Financial Reporting Directive can be an important policy instrument for creating a harmonised European framework for the disclosure of ESG information by European companies and would like to recognise the Commission’s efforts to work in the last 18 months with investors to understand how we use such information to appropriately calibrate the implementing Guidelines. We are equally pleased to see the Commission seeking to incorporate the work of the TCFD into the non-financial reporting standards – as global consistency is important for investors and issuers alike.

If there are clear and mandatory disclosure standards for issuers to meet, and clarity over policymakers’ expectations on how asset owners incorporate non-financial considerations into their investment decisions, we believe this will be a considerable step towards creating an environment where the market can reward sustainable behaviour by companies.

**Infrastructure**

Infrastructure finance – and in particular a focus on renewable energy infrastructure – is a key component of the debate around sustainable finance, and we believe, rightfully so. We believe that the EIOPA, Commission and co-legislator effort to ensure that infrastructure investments were treated appropriately under Solvency II has ensured that appetite for infrastructure amongst insurers remains robust. So much so in fact that we observe demand by insurers for investable infrastructure projects significantly outpaces a supply of such projects.

EFSI remains an important initiative to the supply of commercially viable infrastructure projects in Europe. We have been supportive of the EFSI project and continue to be so – however, we believe that the next stage of the project could be further optimised to enable greater investment on the infrastructure side (as in our answer to a previous question, we believe that EFSI funding has been more successful thus far on the SME funding side).

The renewed focus on infrastructure and more specifically energy policy (for example directing 40% of the EFSI funding for infrastructure and innovation projects in line with the COP21 goals) is welcome.

More broadly, initiatives such as EFSI will be successful if they acknowledge the needs of private capital and build the appropriate environment to encourage institutional investment in Europe’s infrastructure. Greater private capital markets investment in infrastructure depends on respecting four key drivers: certainty, transparency, appropriate funding structures, and a consistent regulatory environment.

But as the review of the EFSI moves forward, we do believe that there are some specific areas of focus which could invigorate greater institutional investment into EFSI projects.

Firstly, the proposal to combine EFSI with other sources of EU funding complicates the process of assessing the suitability of projects for investment. If, however, this means greater coordination between public authorities it could provide an additional push to address bottlenecks in critical cross-border projects in energy and transport.

Secondly, the published decisions of the EFSI Investment Committee only include a basic description of the EFSI operations approved. They do not explain the reason for granting the EU guarantee, or the additionality or EU added value of a particular operation. The scoreboards for the approved operations are not published. This information would be
valuable to investors and its publication would bring about greater confidence in investing in specific projects.

Finally, we believe that the focus on greater geographical distribution of funding in less-developed regions should not take place at the expense of the principles of additionality or quality of the projects. More broadly, we are concerned that much of the public and policy debate around infrastructure focuses on financing, i.e. “Who provides the capital?” rather than on the critical question of funding, i.e. “Will there be users ready to pay to use the infrastructure when it has been put in place?”. The challenge is to help transform projects with unquantifiable usage/demand risk into projects with measurable usage. Simply providing a first loss guarantee does not turn a project into a viable investment opportunity.

We welcome the Commission’s recent report to the Council and Parliament on accelerating the CMU by addressing national barriers to capital flows which recognizes the importance of these points. In particular, we fully agree with the calls on Member States to promote the opportunities offered by the European Investment Advisory Hub and the European Investment Project Portal, strengthen the role of national promotional banks (NPBs) and the complementarity of public and private funds, and to support the establishment of a network of NPBs, in coordination with the European Investment Bank, to align efforts in support of equity and risk capital and fully deliver on the objectives of EFSI 2.0.

Retail financial services

BlackRock believes that investment by retail savers in capital markets should be a key measure of success for the Capital Markets Union. Capital market investments are an underutilised means of savings by Europeans, and finding ways to turn more Europeans from ‘savers’ to ‘investors’ would not only increase the amount of long term capital that can be deployed to the European economy, but also greatly improve the financial future of individuals. In particular, it is essential to direct a considerably greater proportion of the volume of long term savings allocated to retirement savings to investment in capital markets.

**PEPP**

As such we support the focus on the construction of a personal pensions product (PEPP). If constructed properly, a PEPP could add an important tool to the savings product landscape – however, its success will very likely still depend on incentives for individuals to save in a Pillar 3 pension product (such as support by employers for a complementary Pillar 3 options whether through payroll administration or through matching contributions, tax incentives at the national level), the effectiveness of the product distribution channels, and the PEPP’s classification under the MiFID II rules. The majority of people in the EU are unwilling to take financial advice and so the development of default investment products used as part of retirement savings is the single most important initiative which can be taken to address the lack of allocation of retail savings to capital markets in the EU.

As set out below, we do believe that one of the most important factors in driving take up of a pension product will be finding ways to tackle the advice gap and create a framework where individuals have support when they choose their savings vehicle of choice, whether a PEPP or other long term savings products. We believe that one of the most effective steps to encouraging take up of the PEPP will be employer-sponsored advice supplemented by key messages on the benefits of saving through a PEPP agreed by national governments in coordination with industry and employers.
One of the challenges that the PEPP may face within the current regulatory structure for intermediating investment products is that, because of the inability to redeem funds from the PEPP on an ongoing basis, it would likely be considered a complex product under MiFID II. The requirements on the distributors of financial products discourage the sale of complex products to all but sophisticated investors, which would undermine the PEPP’s effectiveness as a Pillar 3 savings product with wide appeal to individuals. The application of an appropriateness test is inconsistent with the effective roll out of a default investment solution.

Other barriers

However, structural barriers in the retail financial services market do exist – especially for investment products (as compared to basic banking and payments services, for example). We would not agree, per se, with the characterisation in the consultation document that retail investors lack confidence in capital markets full stop. Based on our own research – the annual BlackRock Investor Pulse survey, conducted directly with retail investors/savers in countries across Europe – we feel a more accurate way of describing the barrier is that retail investors lack confidence in their way of accessing markets.

This is an important distinction – and one that points to the most effective starting point as to how to change the savings culture in Europe.

The financial advice gap

Against the backdrop of increased longevity and strained public pension systems, the challenge of personal saving for retirement is significant. One area where we have highlighted in the past is the growing ‘advice gap’ – that is, the growing number of savers who increasingly find financial advice difficult or expensive to obtain. At a time when the need for financial advice is so great for so many, levels of engagement with financial advisors are disappointingly low. In 2015 our survey showed that approximately 17% of individuals surveyed in both the UK and Germany and 14% of individuals in the Netherlands currently use the services of an advisor.

National governments and industry should focus on the development of clear and engaging messaging to help people save more and better for retirement. The later people leave saving for their retirement, the more expensive a process it becomes and the greater the risk that they may need to work longer to generate sufficient retirement income. Key to this is convincing people to save earlier to make their money work more efficiently and take advantage of the benefits of compound interest with a comprehensive framework for long-term savings.

Technology offers the opportunity to address many of the barriers people face when they try to take control of their retirement savings. In today’s society, younger consumers move homes and jobs much more frequently than in previous generations. As such, an individual is likely to have contributed to multiple pension schemes and the risk is that people lose track of their savings and are unable to assess whether they are on track with their retirement planning. Account aggregation technologies play an important role in allowing people to see all of their accounts in one place. We set out below some specific examples of how these technologies could assist in supporting retirement savings.

In particular, we support wider industry initiatives such as the development of a digital identity providing people with a single point of entry to a range of different financial service providers such as insurers, banks, and asset managers. This would make it much easier for people to manage their assets in one place, with the added benefits of all anti-money laundering and know your customer procedures being completed once, up front. An initiative like this would reduce complexity and would mean that individuals would be less likely to lose track of their savings, as they could all be accessed in one place. A Digital ID would facilitate the
development of digital account aggregation applications, especially if linked to a facility that would automatically update an individual’s profile as their circumstances change.\textsuperscript{5}

Technology can also play an important role in helping to bridge the advice gap. Beyond the development of a digital ID we believe that so-called ‘Robo Advice’ – that is, automated digital investment advice – can play an important role in bringing basic levels of financial guidance and advice to individuals; both by providing a cost-effective way for individuals to obtain advice, but also by helping to reduce the cost of full-suite investment advice provided by a financial advisor by supplementing traditional advisory models.

We would be pleased to see the development of specific regulatory regimes for generic guidance, which could help bring savers put off by the cost and perceived complexity of full-suite investment advice on appropriate savings products.

\textbf{Optimising public capital markets}

Though MiFID covers a number of the main issues we have raised in the context of the CMU review and recommendations, there are still important areas of focus for the Commission to create a more highly-functioning public capital market that can better intermediate capital throughout Europe.

Overall, we believe that public capital markets are the segment of the market closest to realising the ambitions of the CMU: that is, a well-regulated market that enables cross-border investment and flow of capital. However, there are indeed further areas of focus that we believe can help optimise the functioning of this market and ensure that it works in the best interest of both investors and the ‘real economy’ users of capital.

Capital markets broadly have undergone significant structural changes since the financial crisis. Some of this change has been driven by regulation (however, often it has been the \textit{intended} consequence of regulatory efforts, rather than an unforeseen side effect – for example, increased capital charges on banks’ trading books, making it more expensive for dealers to hold inventory of securities), and some of it has been driven by business and macroeconomic realities. What we see currently, and where we expect especially public capital markets to continue to move towards in the near future, is a less-dealer driven market structure, where market participants trade directly (and often electronically). This means that the concepts of price formation, liquidity, and execution are evolving as well.

Technological change is becoming an important driving force, and we welcome the Commission’s initiatives to look at FinTech more broadly. But perhaps most important is maintaining a view of the future realities of public capital markets as the Commission finalises a range of primary legislation, which are likely to be the regulatory foundation for years to come. Broadly speaking, we believe that the CMU presents an opportunity to ensure that rules for public markets are appropriately calibrated for what markets are likely to look like in the future, not what they looked like in the past.

\textit{Corporate bond markets}

While considerable reform has been agreed for equity markets (but must be secured fully in implementation), fixed income markets are in need of greater scrutiny. We welcome the European Commission’s review of the functioning of corporate bond markets in the EU as part of the CMU framework. An overarching element of the CMU agenda that also supports the development of the European corporate bond markets in parallel is the ongoing assessment of the cumulative impact of regulation. The cumulative impact of permanent shifts in regulation impacting banks and market structure, combined with temporary macro-

\textsuperscript{5} The Savings and Investment Project, ‘Saving our Financial Future’, 2015
economic factors, have been attributed to reduced secondary market liquidity in global corporate bond markets in recent years.

We also believe that, moving forward, the European Commission has an important role to play to coordinate and monitor steps that the private sector can take collectively to address the liquidity challenge. These steps could include:

- The development and widespread adoption of new and existing products that help market participants address challenges associated with changes in fixed income markets.
- A greater use and acceptance of all-to-all trading venues, where multiple parties, from both the buy side and the sell side, can come together to transact to provide opportunities to increase liquidity.
- The buy side should be encouraged to adapt trading behaviours: to not just be a price taker but also a price maker where it helps end-investors obtain more market liquidity at a better price.
- While liquid (or benchmark) bond issues are less applicable for smaller issuers or those that do not issue bonds frequently, the market would benefit from larger issuers incorporating a greater use of benchmark issues into their capital structures. This could be brought about by large and frequent issuers migrating to more standardised features over time, thereby concentrating liquidity in fewer and less distinct bonds.

**Repo**

We are also pleased to see repo feature as a sub point within the discussions around market liquidity. Repo is incredibly important and an area which has come under significant stress recently as the dealer-intermediated structure of the repo market is challenged by new bank capital rules. European repo markets are increasingly coming under significant strain at quarter- and year-end dates – when price dislocation is severe and supply is constrained notably.

The strains on the repo markets are complex and multi-faceted. Bank regulation (in particular, the Basel leverage ratio and the Net Stable Funding Ratio) is undoubtedly causing pricing pressure on dealer-driven repo, but changes to market liquidity and clearing and settlement infrastructure, coupled with demand pressures from the growing importance of repo to facilitate cash margining required in derivatives clearing, have all contributed towards the issues.

We do not believe there is a simple, or easy, solution to the strains European repo markets are experiencing. Part of the response will undoubtedly be a structural adaption of the markets – likely driven by technology – such as increased repo clearing. But we believe that European policymakers should look closely at repo markets and balance the considerations of ongoing policy debates (e.g. the banking package currently under discussion, or the CSDR Level 2 rules) with the need to have a functioning European repo market.

**Post-trading: Clearing & settlement**

We believe an important objective for the CMU is to ensure that investors are protected throughout the process of their capital being invested in markets. In this vein, a key piece of completing the regulatory framework for post-trading in our mind, is addressing concerns around the recovery and resolution framework for CCPs. Clearing is a central piece of market infrastructure, and addressing some of the very real investor protection
concerns around what would (and wouldn’t) happen in the event of a CPP coming into
distress is an important piece of the legislative framework that can give investors greater
certainty that their interests will be protected as their capital moves through markets.

We are pleased to see the Commission’s legislative proposal in this area. The
Commission proposal is largely consistent with international initiatives in this area – and
we welcome the efforts to both drive global standards in this regard and to seek to
maintain international consistency – but we believe that the final rules can and should go
further to protect investors.

We believe that investor protection and confidence in clearing could be severely
undermined by rules that misses an opportunity to make CCPs more resilient, and in the
event of a resolution, could jeopardise client margins at the expense of less potentially-
procyclical sources of capital.

Improvements across Europe to settlement systems are also welcome. The CSDR is an
important piece of regulation on settlement systems, and we believe that the important
improvements have been made to the Level 2 measures that create more workable buy-in
procedures (buy-ins are largely at the trading level, rather than venue or settlement agent
level, a longer fail period before the buy-in, and important exemptions for short-dated
securities financing transactions). However, we do believe that the CSDR rules will further
reduce market liquidity in certain asset classes (especially credit, high yield, and emerging
market debt), and could undermine confidence in the securities lending and repo markets,
where the providers of collateral may be less willing to lend it due to increased uncertainty
over whether or not they will get it back.

We believe that calibration of these rules in the clearing and settlement space should also
take into account the Commission’s work on liquidity in fixed income markets and the
functioning of repo markets, and ensure that the final rules do not undermine the (laudable)
aims of promoting more highly functioning public capital markets.