



CAPITAL MARKETS UNION

#CMU

Capital Markets and funding EU SMEs:

Budapest Stock Exchange for Successful SMEs

Budapest, November 16 2016

Niall Bohan

Head of Unit, Capital Markets Union
DG Financial Markets, European Commission

Overview:

1. How capital markets can help to fund the EU economy;
2. Capital markets in MS with high catch-up potential;
3. Progress in delivery of of CMU.

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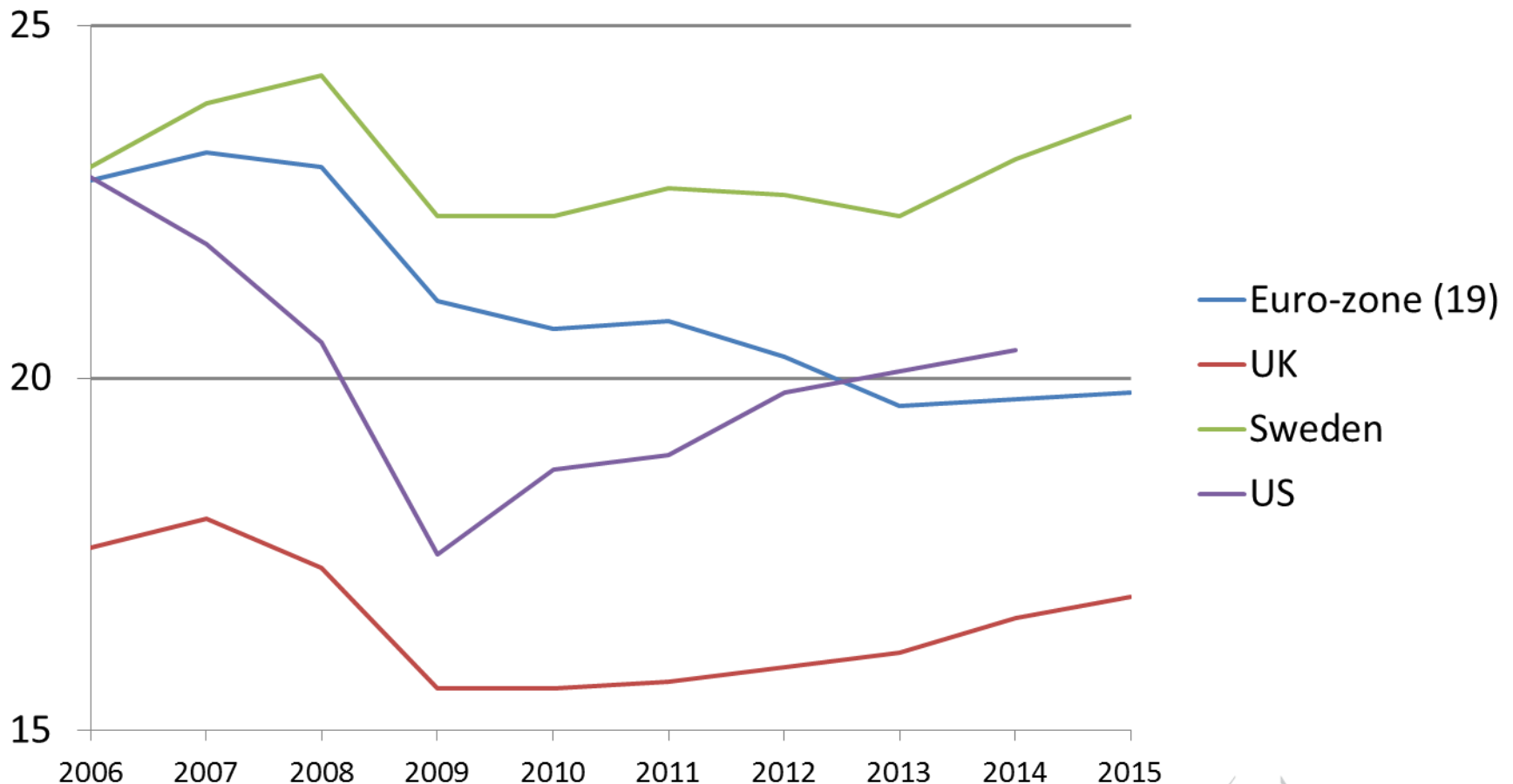
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1. How capital markets can help to fund the EU economy.



Investment (EU vs US):

Gross Fixed Capital formation as % of GDP



Purpose of CMU:

Policy objective:

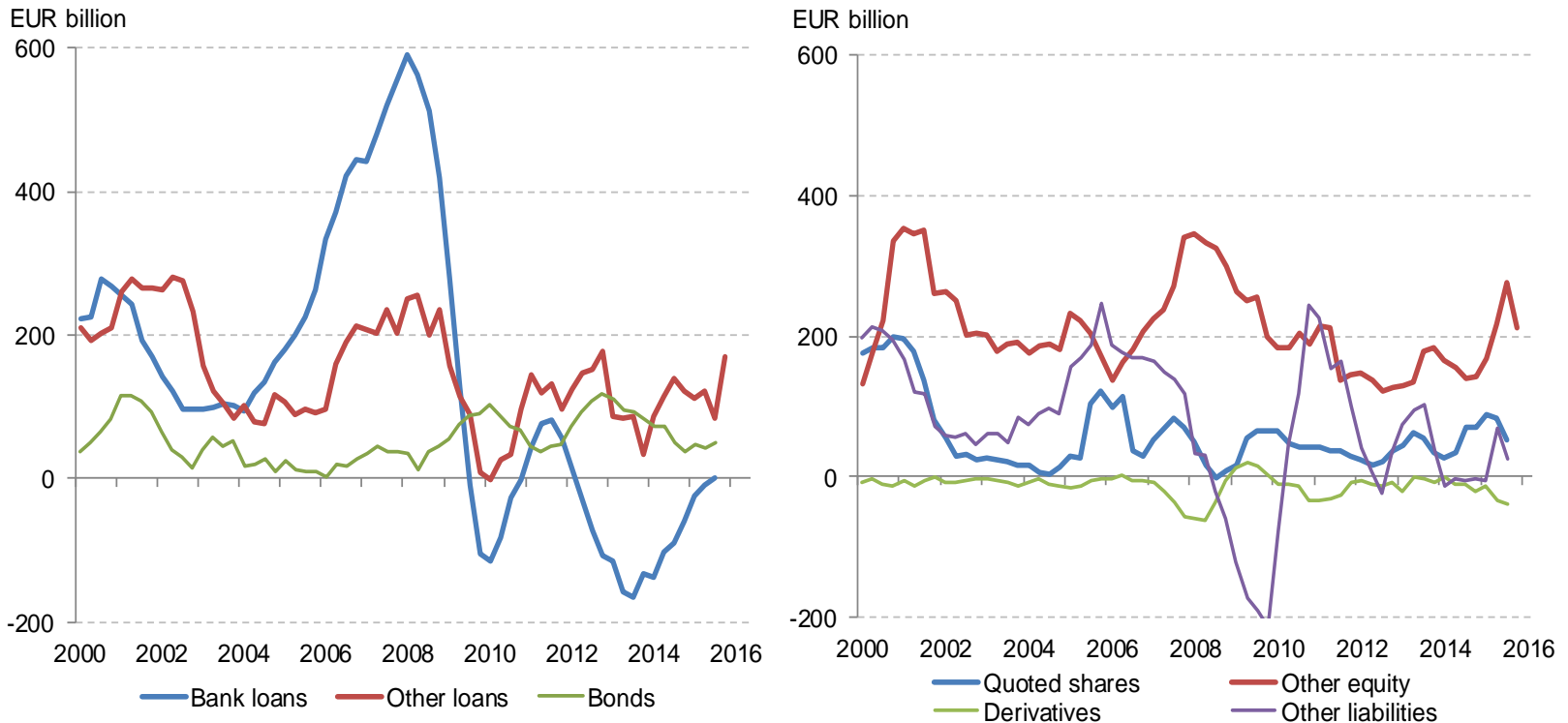
- Regulatory reform programme to diversify the funding of EU economy, reduce over-dependence on bank loans.

Why?

- Increase market-based finance from various sources and building a stronger equity culture to complement bank lending;
- Stimulate long-term finance for infrastructures and SMEs;
- Strengthen risk diversification and shock absorption by removing barriers to cross-border capital flows and investment.

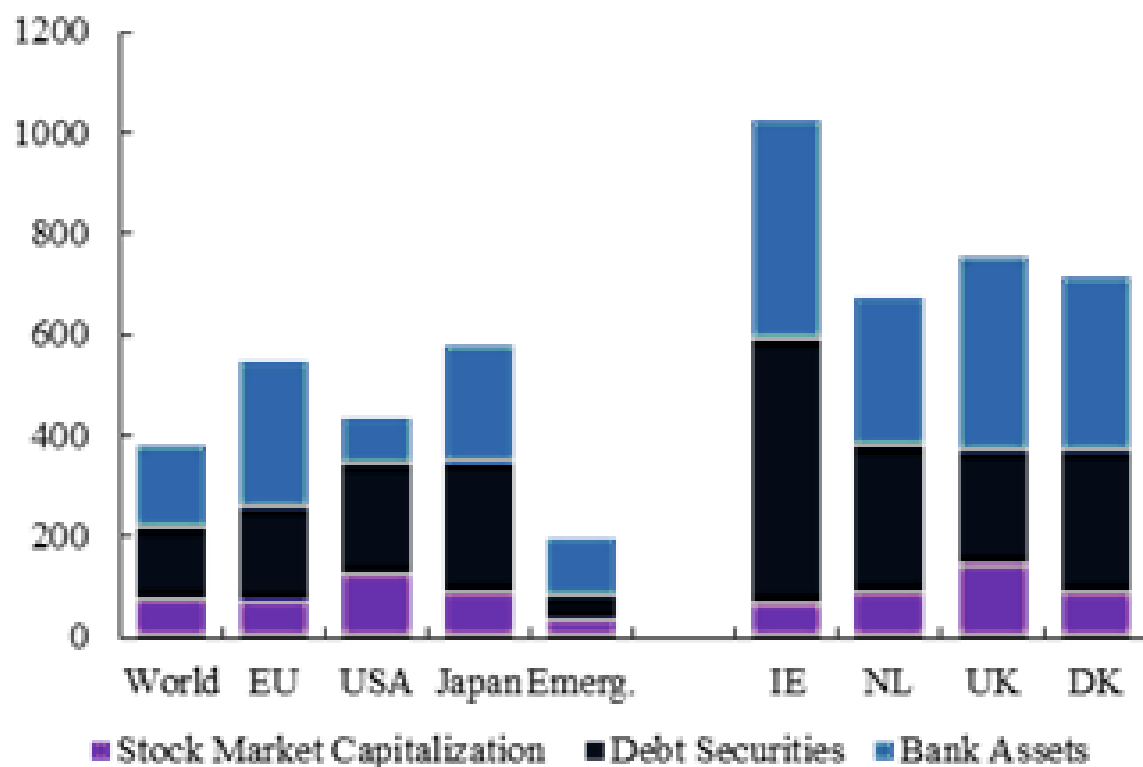
Bank loans more pro-cyclical than market funding

Chart 2.13: Dynamics in NFCs' sources of funding (liabilities) in the euro area



Source: ECB, Eurostat and own calculations

EU financial markets in perspective:



LU not shown because of different scaling, total assets = 3000 % of GDP

Source: IMF.

Funding of EU SMEs:

Sources (private only) of SME funding for US and EU, stocks and flows, in 2013

		Stock		Flow	
		US (€bn)	EU (€bn)	US (€bn)	EU (€bn)
Banks	Loans & securitised loans	494	1,543	286	748
Non banks	Mutual funds + individual mandates	112	98	11	7
	PE funds	59	32	14	9
	VC funds	104	22	26	5
	Family and friends	371	168	186	84
	Crowdfunding	3	1	1	1
	Angel investing	39	11	20	66



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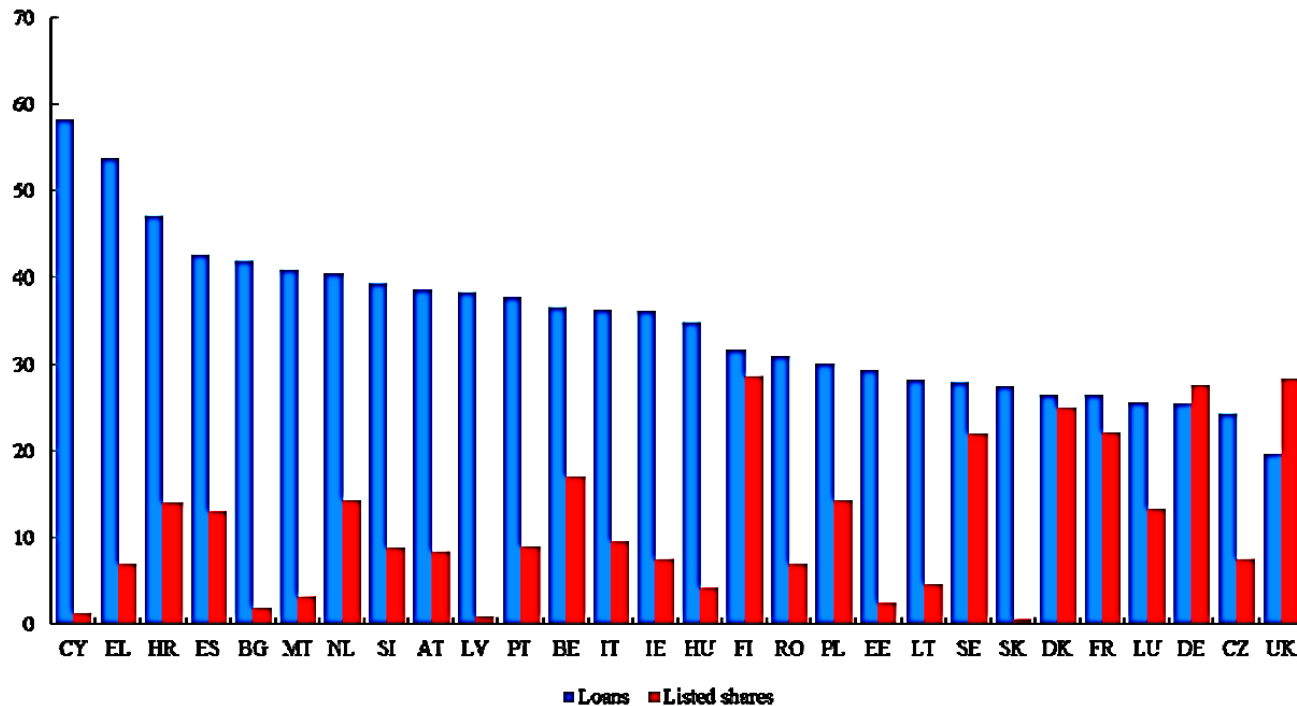
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2. Capital markets in MS with high catch-up potential:



Bank loans as source of NFC finance:

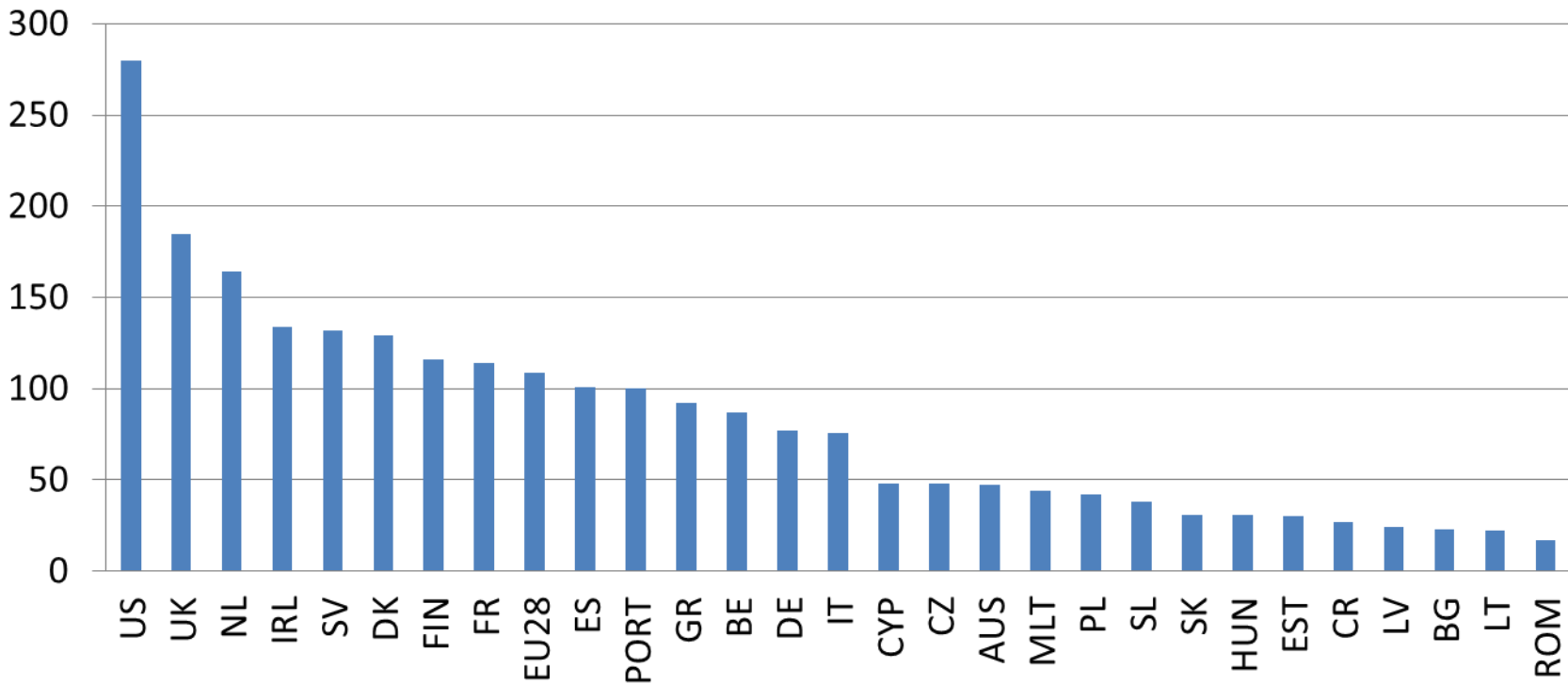
Funding of companies: banks vs stock exchange, Loans and listed shares as % of total liabilities of non-financial corporations, 2014 or 2013



Source: Eurostat.

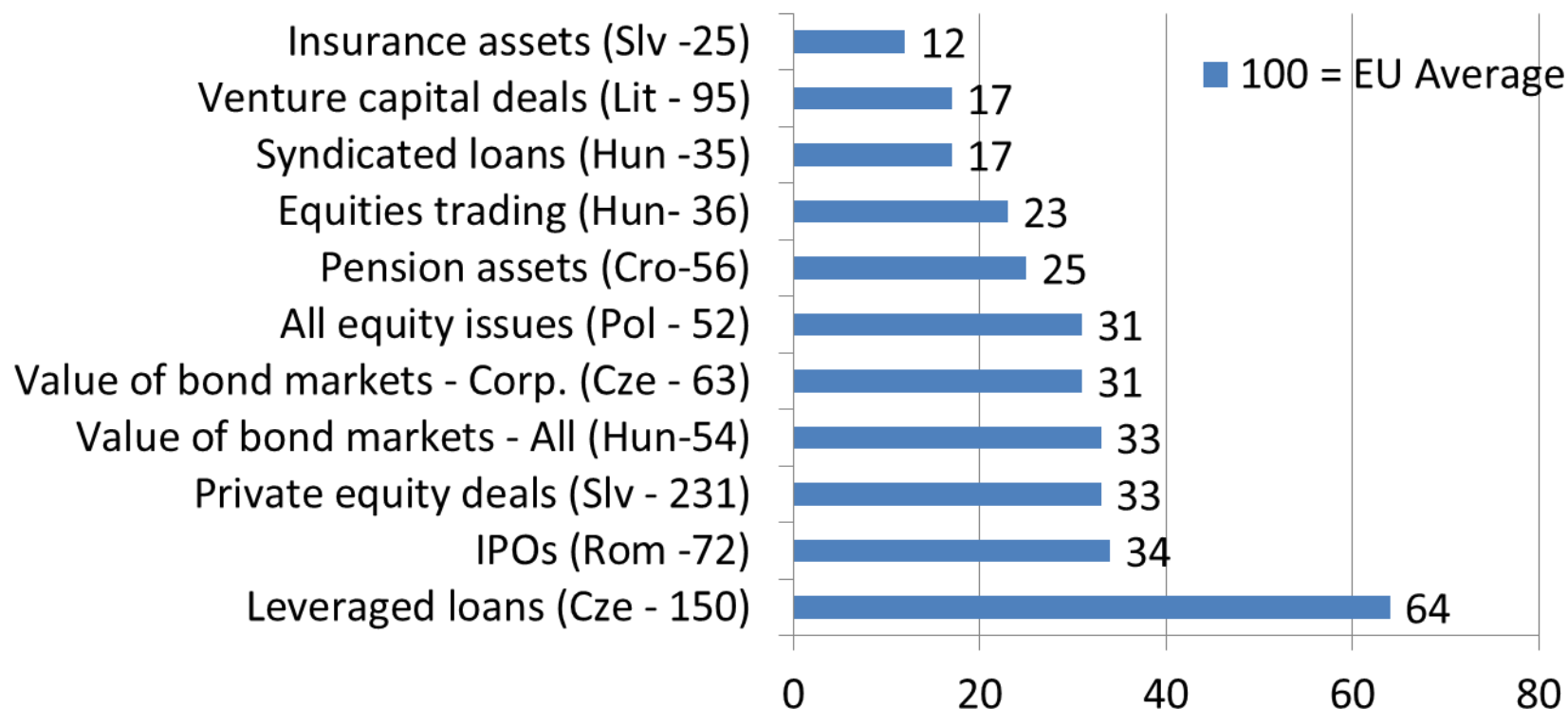
Depth of capital markets across EU

EU average 2011-14 = 100



Source: New Financial 2016

The depth of different sectors in EU11 capital markets* (In brackets: most developed market and score)



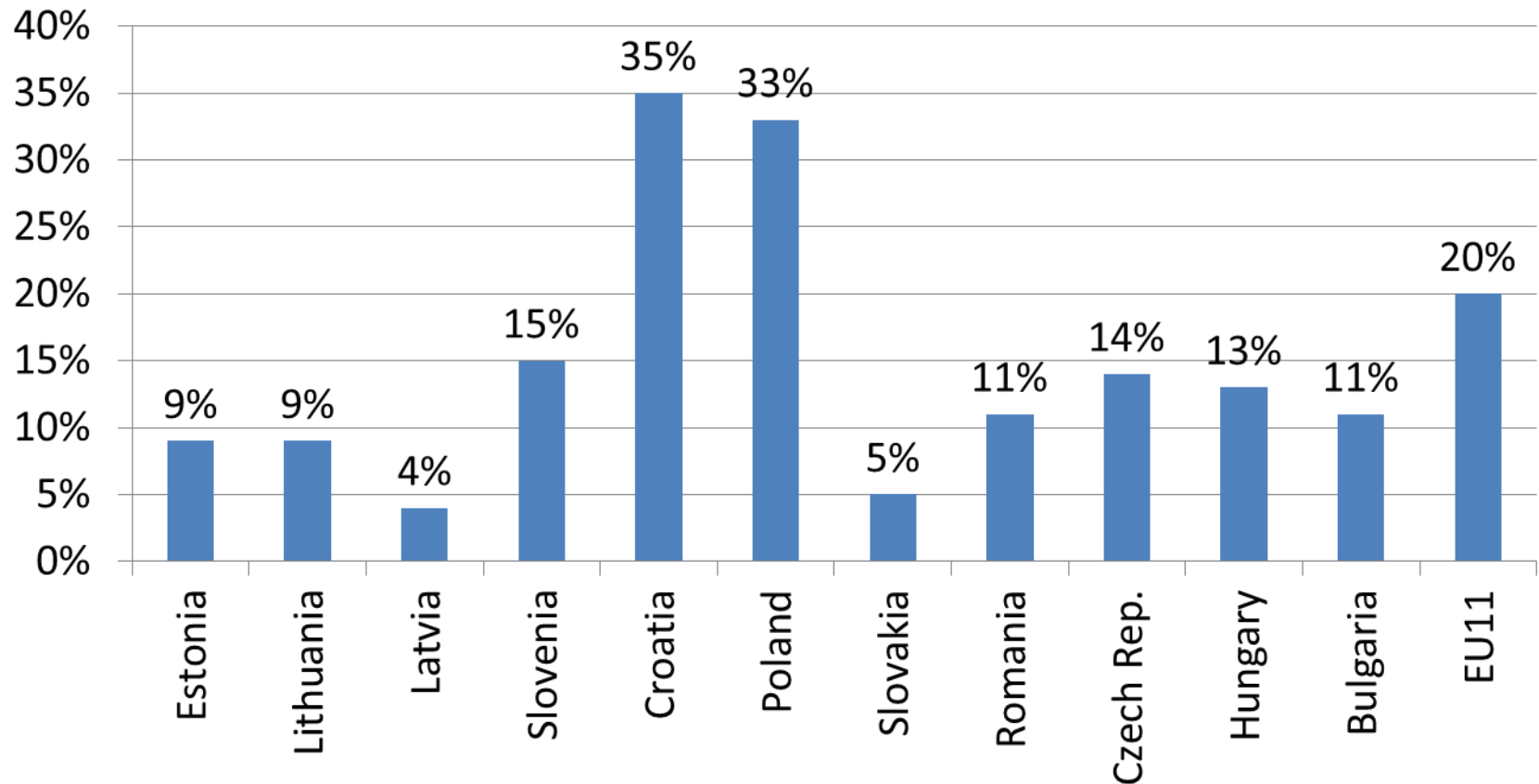
*Depth of capital markets by sector in the EU 11 relative to GDP and average in the EU; Three years to 2015; source: AFME: The Benefits of capital markets to high potential EU economies, Nov 2016

Summary of market infrastructure in the EU11 (*)

Country	Stock exchange	No of listings on SE	SME/growth market	No of listings on SME/growth market
Estonia	Nasdaq Tallin	16	First North Baltic	1
Lithuania	Nasdaq Vilnius	34	First North Baltic	1
Latvia	Nasdaq Riga	28	First North Baltic	1
Slovenia	Ljubljana SE	41	Entry market	26
Croatia	Zagreb SE	171	-	
Poland	Warsaw SE	905	New Connect	400
Slovakia	Bratislava SE	50	-	
Romania	Bucharest SE	84	Aero	6
Czech Rep.	Prague SE	25	START	0
Hungary	Budapest SE	45	-	-
Bulgaria	Bulgarian SE	365	-	-

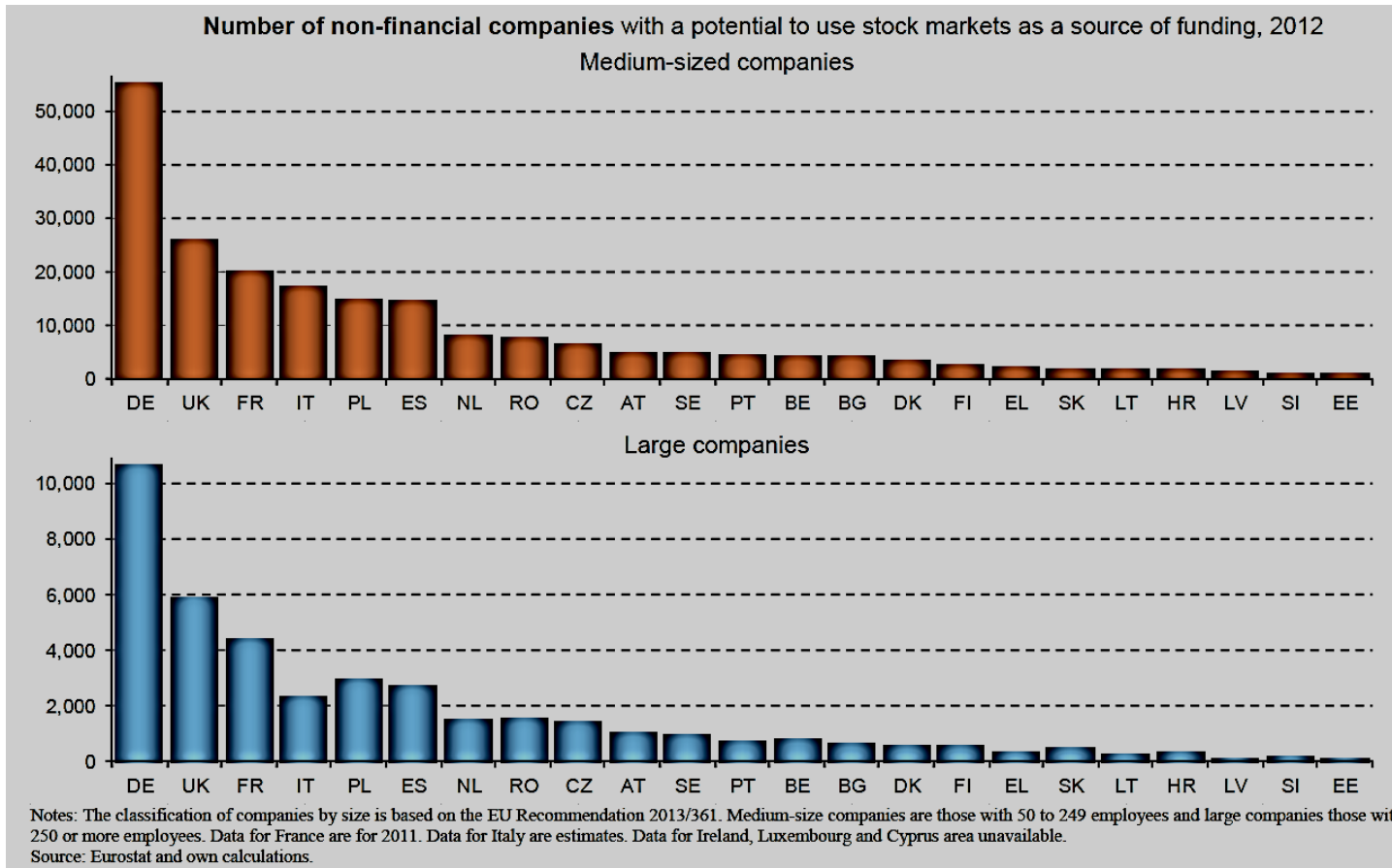
*Source: AFME: The Benefits of capital markets to high potential EU economies, Nov 2016

Stock market capitalisation as % of GDP (*)

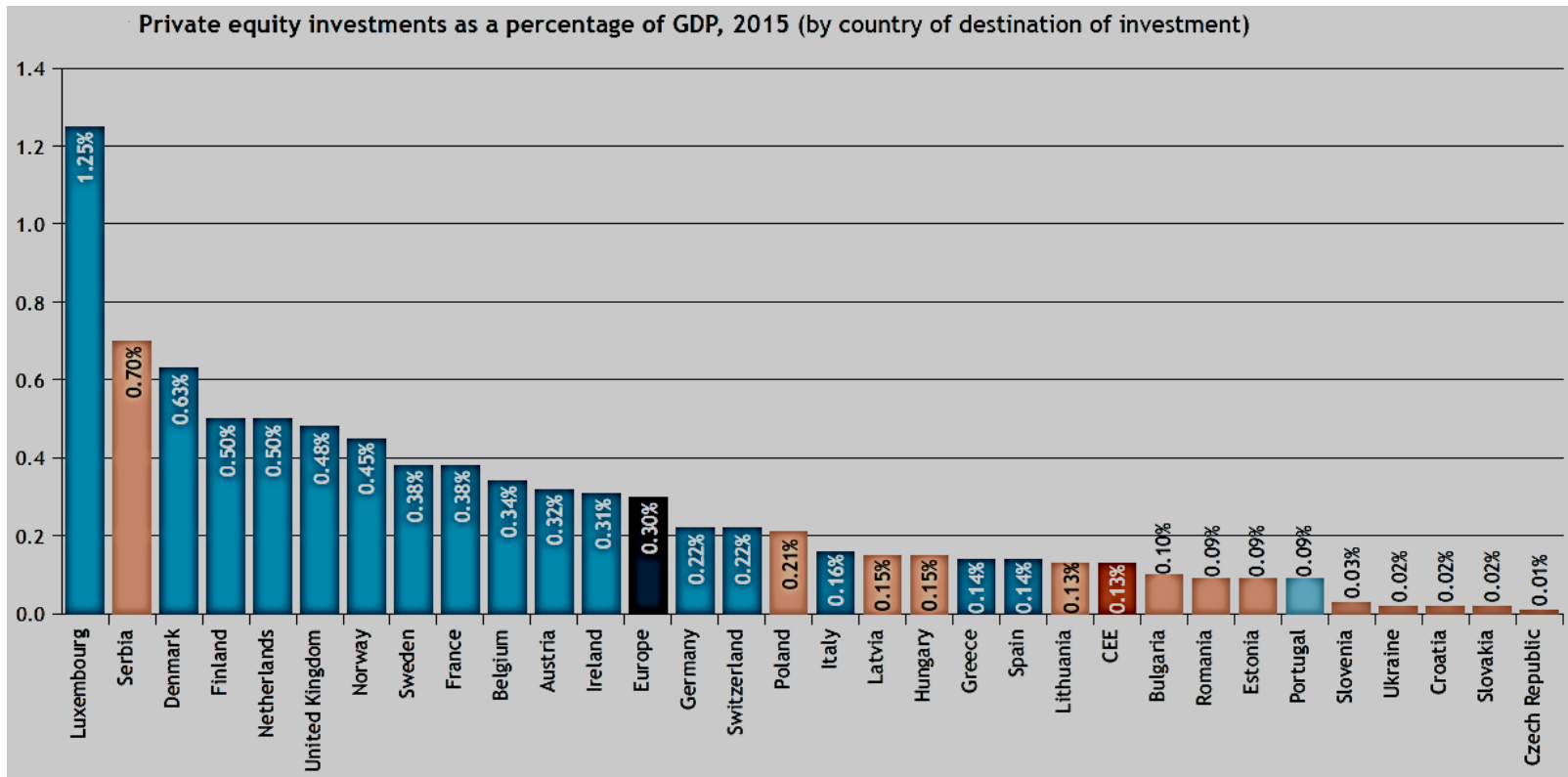


*Source: AFME: The Benefits of capital markets to high potential EU economies, Nov 2016

Size profile of corporate sector:

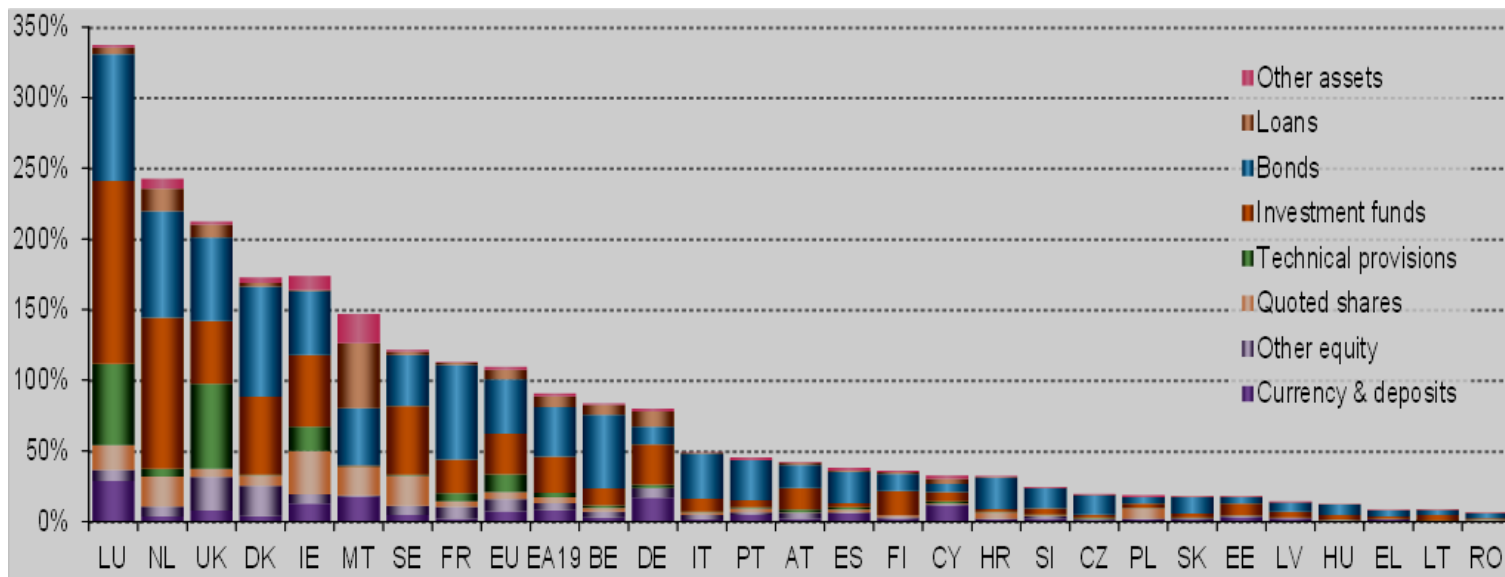


Sources of non-bank finance: private equity

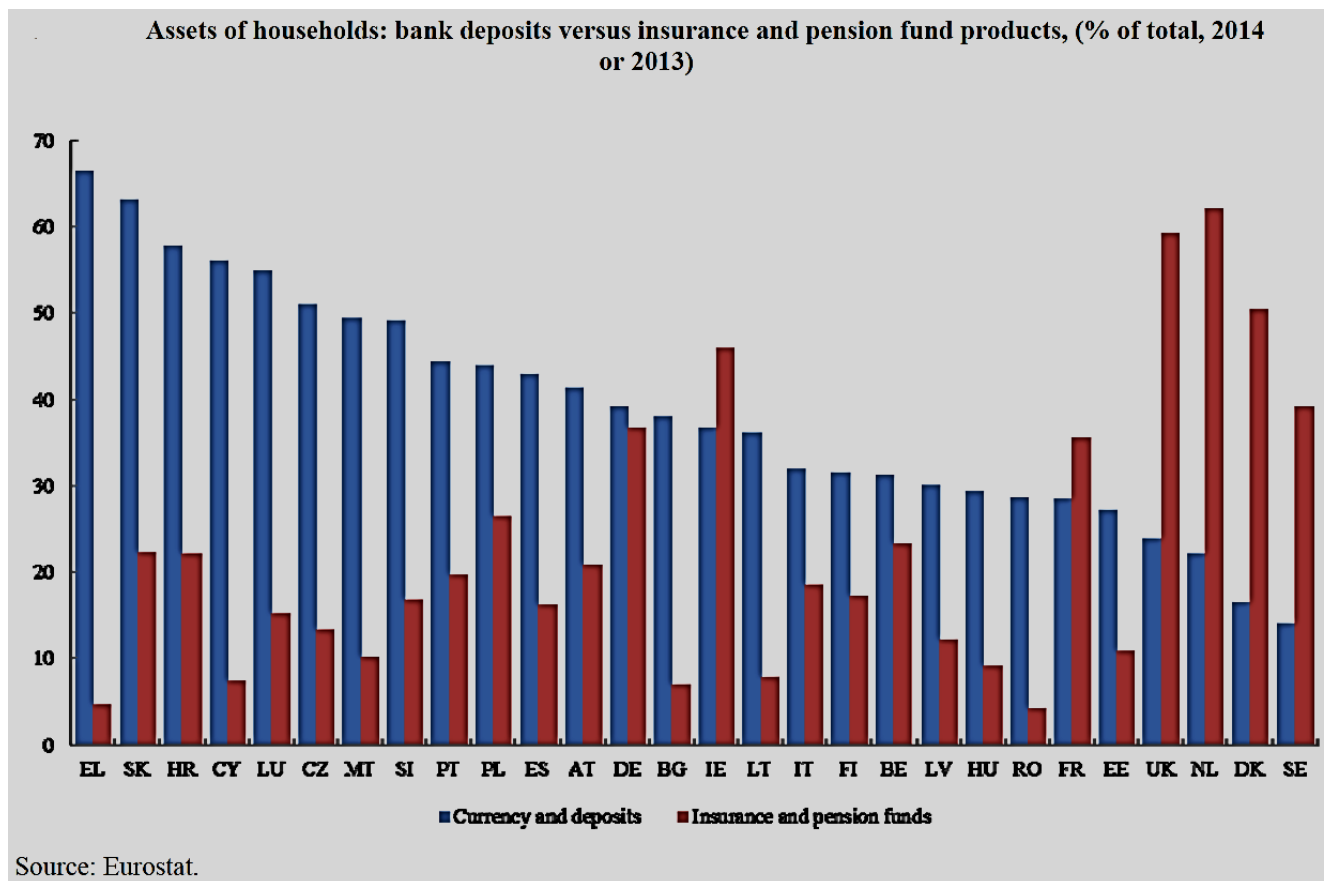


Availability of capital: institutional

Insurance Corporations and Pension Funds' Assets (share of GDP, Q3 2015)



Availability of capital: retail investors



Work-streams for capital market development:

1. VC fund-of-funds – to expand reach of EU VC industry to wider range of MS;
2. SME growth markets;
3. SME information services;
4. Develop focus on access to finance/CMU in Vienna Initiative;
5. Technical assistance for access to non-bank finance (Structural Reform Support Service).
 - Agreement on global budget for SRSS (140m€) expected early 2017;
 - 1st pilot projects (ROM) agreed.



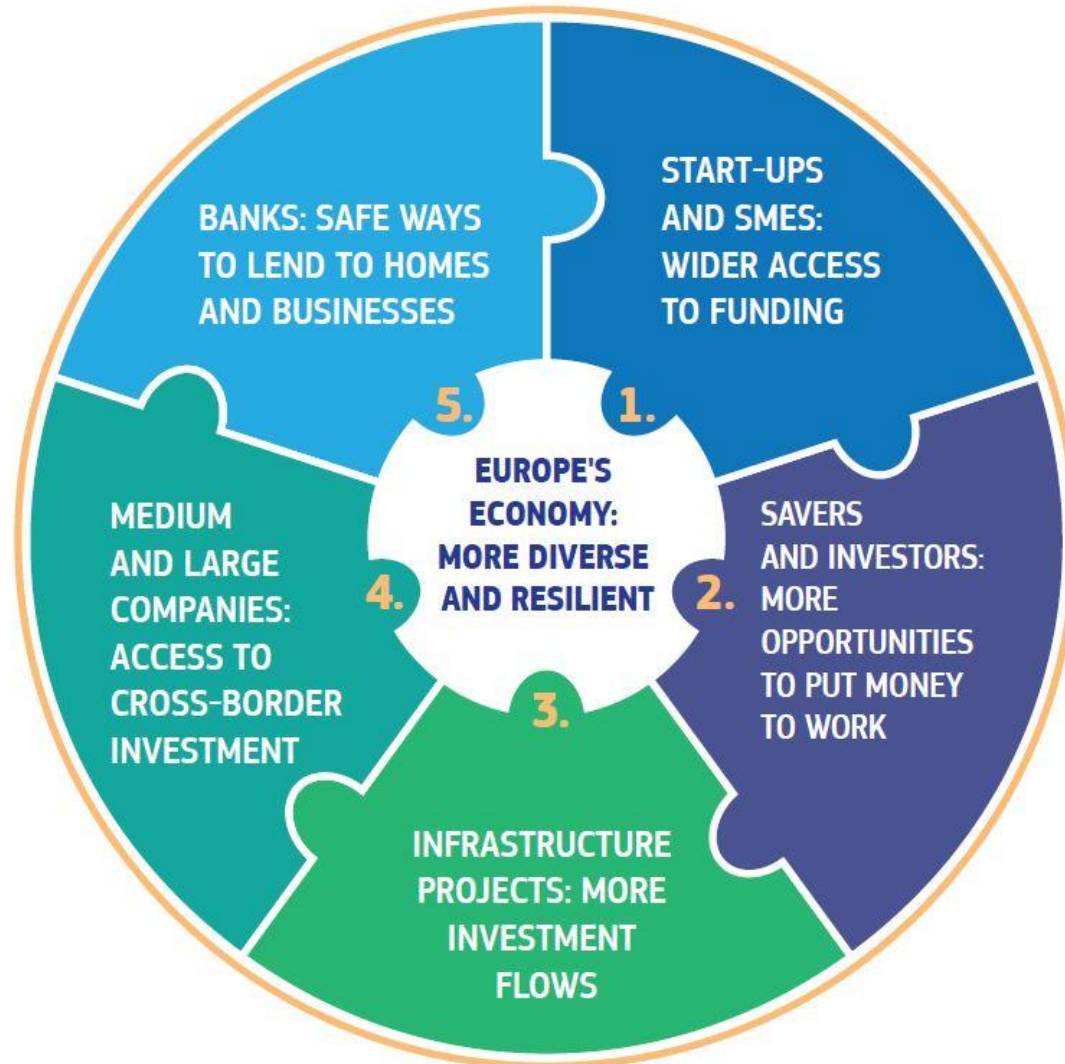
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3. CMU delivery to date:



CMU = finance for investment & growth



September 2016 – accelerate CMU delivery

September 'State of the Union' Communication: 3 messages

- (1) finalise first set of CMU legislative actions;
- (2) accelerate delivery of next set of measures;
- (3) Explain how Commission will take forward CMU.

Why?

- Evolving economic and market developments crystallised need for a policy response and new priorities:
- In other areas where work has been launched under CMU Action Plan, a more comprehensive and ambitious approach is needed, e.g. supervision.

Finalise legislative proposals

Policy field	Policy Challenge	State of play
Securitisation	Collapse of EU securitisation markets despite low default; Restore markets as means of managing bank balance sheet, funding loans.	Member States agreement (Nov 2015); EP vote end 2016 followed by EP-Council negotiations; Adapt capital charges for insurance.
Venture capital (EuVECA Reg)	Small funds (av. = 90m€ AuM) poor returns, limited geographical focus; Expand eligible assets (listed SMEs) and managers.	Secure MS agreement by end-2016; EP vote allowing final agreement in early 2017.
Prospectus Regulation	Disclosure requirements absorb up to 8% of mid-cap IPO. Streamline public offer documents, reduce scope.	Efforts underway to conclude final agreement between Council and EP under Slovak Presidency

Recent/forthcoming legislative proposals

Policy field	Policy Challenge	State of play
Equity tax allowance	Address tax bias in favour of debt by providing corporate tax offset (baseline + 2%) for cost of equity.	CCTB Proposal adopted on 25/10;
Preventive restructuring & second chance	Avoid unnecessary liquidation of viable companies, give 2 nd chance to deserving entrepreneurs	Proposal to be adopted end Nov;
Infrastructure investments	Adjust Solvency II calibrations for investment in infrastructure including infrastructure corporates and ELTIFs	Assessment of infrastructure corporates ongoing; Reduce bank capital requirements for investment in infrastructure.

Next wave of CMU priorities:

- **Personal pensions:** possible legislative proposal (2017);
- **Retail financial services:** action plan to open up EU market for retail financial services;
- **Securities law:** Legislative proposal to clarify applicable law for competing claims on securities or debt assignments traded cross-border (2017);
- **Sustainable and green finance:** mobilise private capital to finance sustainable growth. Expert group to develop European strategy on how to integrate in financial framework;
- **FinTech:** innovative potential should be harnessed while protecting investors (crowdfunding, robo-advice).

EU retail investors and CMU:

Starting point:

- 1/3 of EU household financial assets in banking deposits;
- Missed opportunities: Over past 50 years, European equities delivered 6% real return annually, versus 4.9% for bonds and 0.9% for cash;
- Indirect exposure to capital markets via funds (or unit linked life insurance); distribution/management fees erode net performance;

Avenues to improve EU retail investor outcomes:

- Recent efforts to increase transparency of investment products at national & EU level e.g. Key Information Document (*KID*), PRIIPS;
- Increasing market share of Exchange-Traded Fund (ETF);
- Increasing sale online : Fintech to challenge bank dominance of fund distribution;
- CMU action: EU retail investment product markets assessment.

Conclusions/Prospects:

- A long-term agenda which remains at heart of EU investment and jobs strategy despite recent developments;
- Economy moving towards more market based finance:
- Which parts of the financial system will work best for Member States in catch-up phase?

- **Next step: evaluation and review in mid-2017.**



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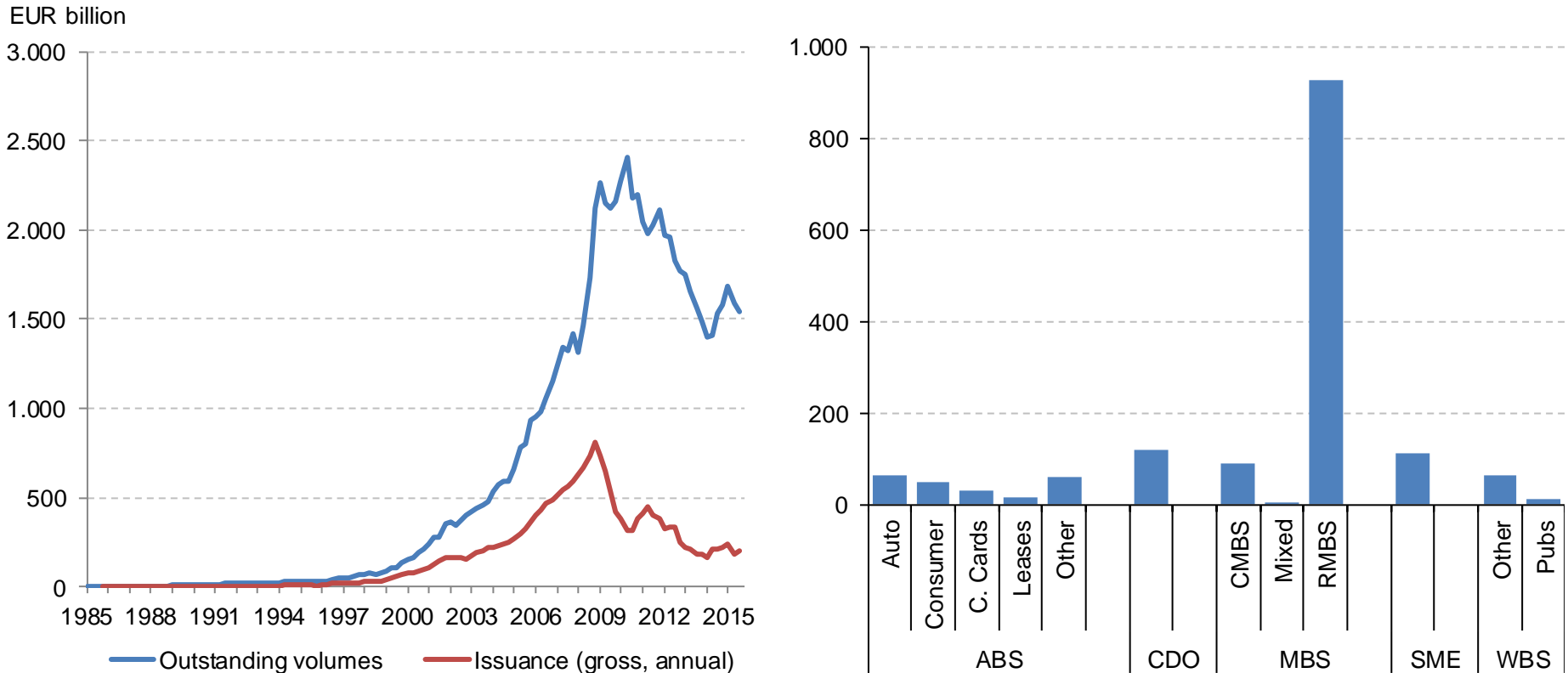
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Annex:



EU securitisation markets

Chart 2: Securitisation in Europe - total outstanding amounts and by collateral class (2015-Q3)

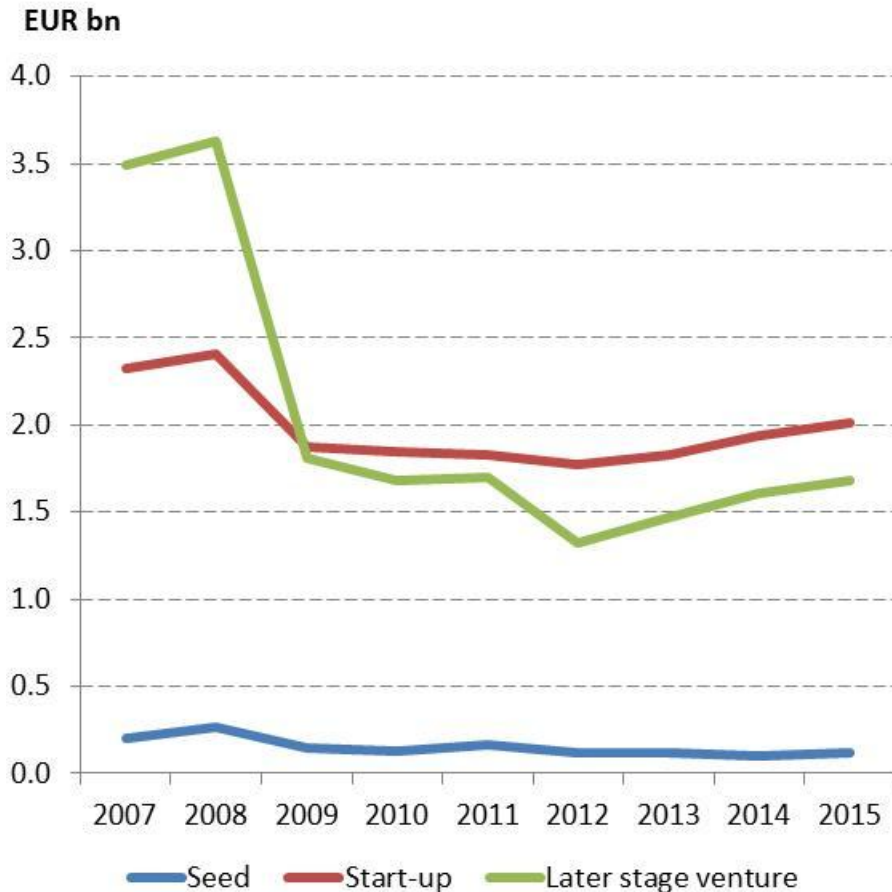


Notes: ABS: asset-backed securities; CDO: collateralised debt obligations; MBS: mortgage-backed securities; CMBS: commercial mortgage-backed securities; RMBS: residential mortgage-backed securities; SME: small and medium-sized enterprises; WBS: whole business securitisation.

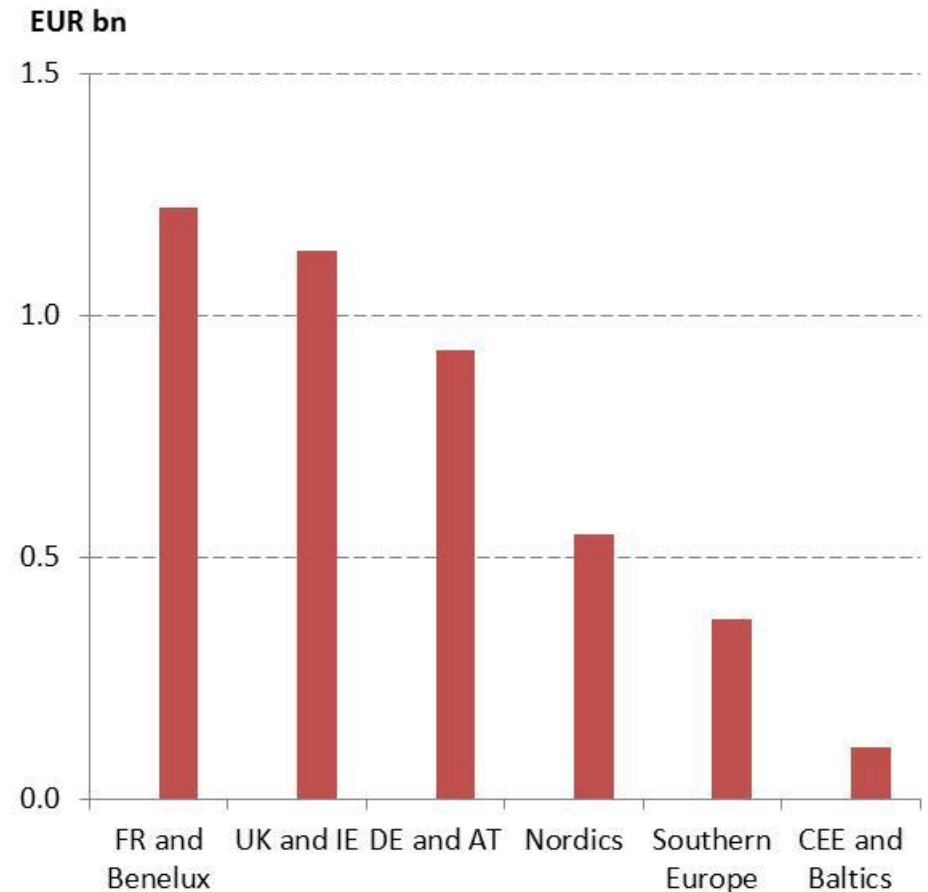
Source: AFME, SIFMA, ECB and own calculations

VC investment in Europe

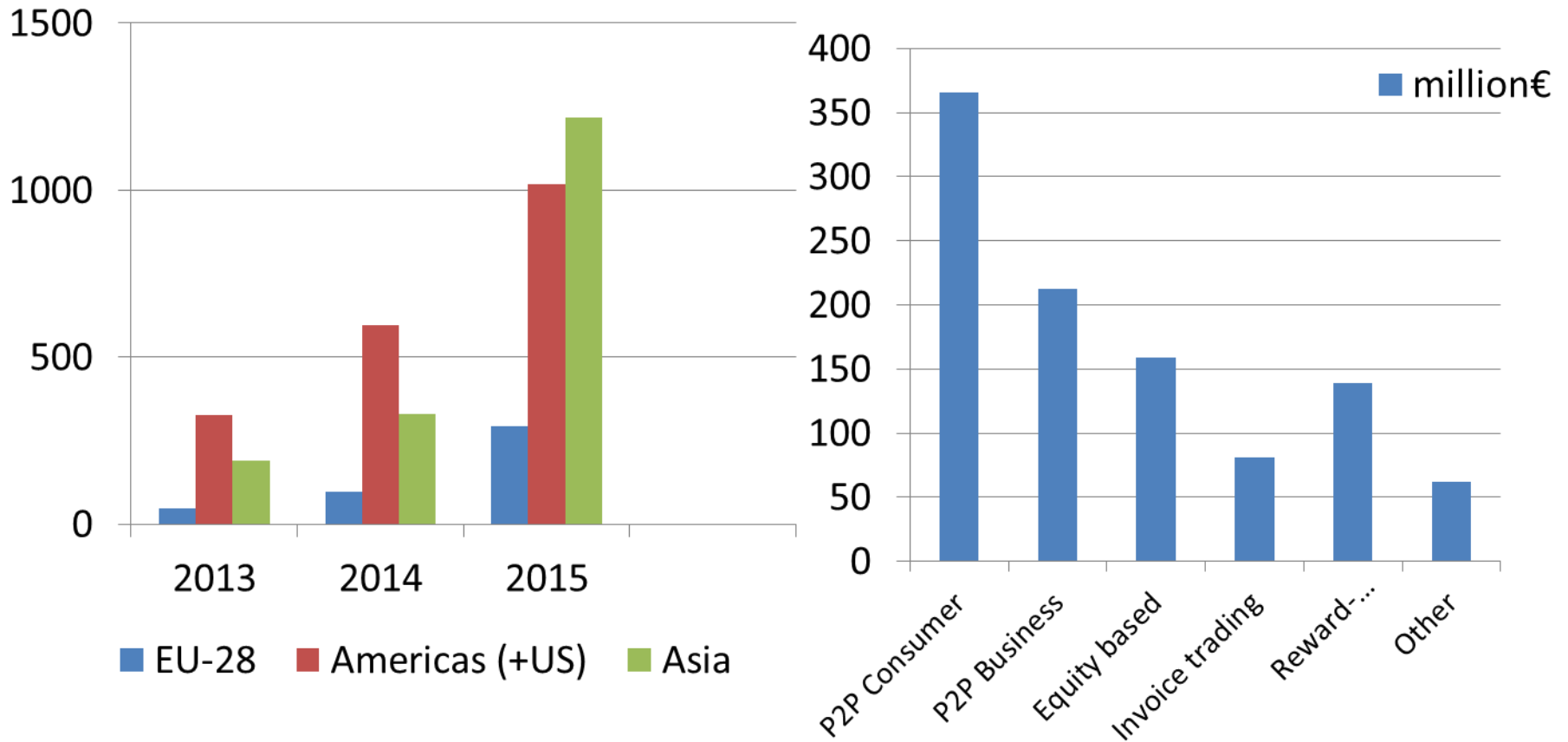
VC investments by stage, 2007-15



VC average yearly investments by region, 2007-15

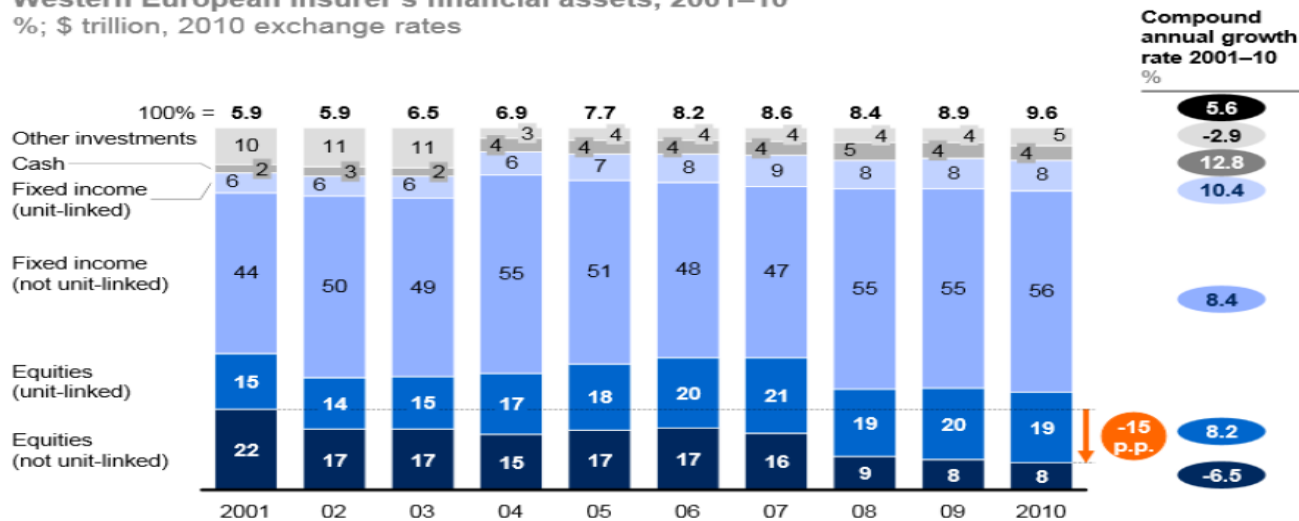


European crowdfunding (in m€)



Insurers – investment portfolio:

Western European insurer's financial assets, 2001–10
%; \$ trillion, 2010 exchange rates



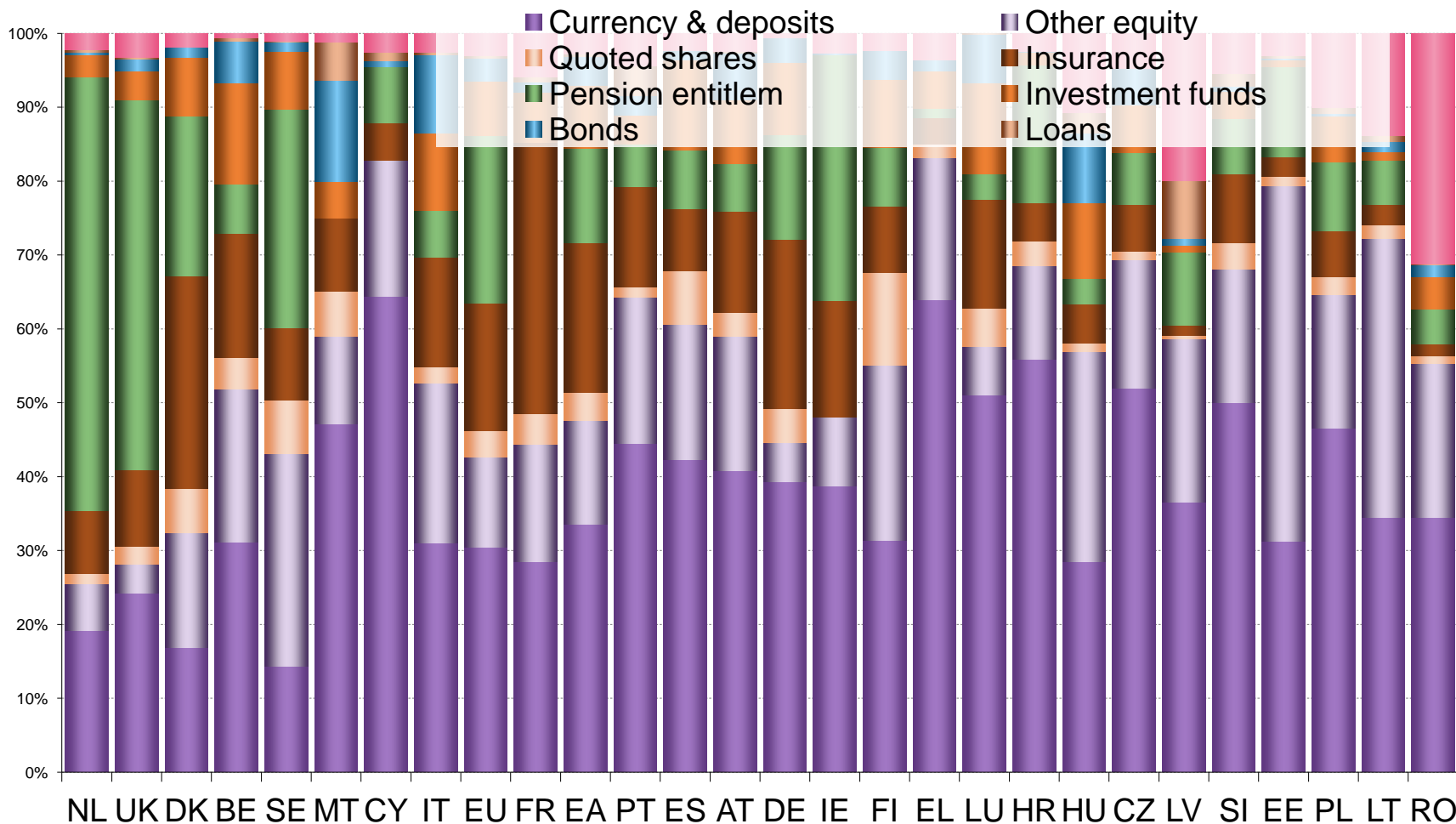
1 Includes investments for which policyholders bear the risk.
NOTE: Numbers may not sum due to rounding.

Source: Roxburgh C., Lund S., Dobbs R., Manyika J., and Wu H., *The emerging equity gap: Growth and stability in the new investor landscape*, McKinsey Global Institute, exhibit A15, page 79, quoted by the EU IPO Report, March 2015

Western European insurers have reduced their equity holdings from 22% to 8% of total investments between 2001-2010. Real estate investments also shrink.

Source: Better Finance

EU Household's financial assets



Notes: Data for Bulgaria and Slovakia are not available.

Source: ECB, Eurostat and own calculations

Retail investors: need for personal pension products:

- Number of > 60 year-olds grows by 2m each year in EU and the number of people 20-59 will fall every year over the coming decades (EFAMA);
- Millennials expected to have 14 different jobs during working life – pension solutions need to recognise professional and geographical mobility;
- Worrying situation regarding performance of occupational and other retirement related vehicles (net of inflation, tax, administration = approx. 0%);
- Need to facilitate emergence of scalable, affordable, steady return products (possibly in return for reduced redeemability);
- Develop EU markets for individual pension products (3rd pillar) to achieve scale: start policy development with consultation in June.