EU Capital Markets Union Green Paper

Grant Thornton's response to consultation document

Filed 13 May 2015

Please note, the **Appendix** contained at the end of the document includes a standalone piece submitted to the Commission. It speaks to the wider issues facing mid-sized businesses and may serve as a public statement on our point of view.

Question 1: Beyond the Commission's five priority areas identified for short term action, what other areas should be prioritised?

We believe the Commission has identified reasonable short-term priorities, and recommend three additional priorities for consideration:

- engage investors, lenders and economists to clarify the quantitative and qualitative factors most important when financing mid-sized businesses
- raise awareness of the SME lending programmes in place today
- evaluate appropriate business support programmes which will help drive successful finance solutions for SMEs.

First, the Commission should determine the data needs of investors in mid-sized businesses who are seeking finance. We find that those investors lack information on creditworthiness and risk for the mid-market and consequently there is a barrier to investment in these companies. To address the lack of mid-market information:

- the Commission should bring together potential mid-market investors and economists to identify common information needs
- separately, the commission should consider the lessons from developing markets[1] to identify non-financial data which inform lending decisions.

Second, the Commission should consider how to encourage the success of SME financing programmes already in place, by building awareness of such programmes. Grant Thornton has seen this challenge first-hand in its support of the UK's Growth Accelerator programme, a British government-backed business support and investment readiness programme which connects growth specialists to growing companies and offers support: accessing finance, developing business, supporting innovation, providing leadership and management insight, and connecting businesses across the community.

In a recent report on the programme[2], Grant Thornton UK noted that despite holding an established Venture Capital and SME tax incentive scheme, only 3% of the UK's Growth Accelerator participants (and zero hyper growth companies) accessed the UK's Enterprise Investment Scheme, a UK-government backed initiative to encourage investment into SMEs which offer individuals significant tax incentives to invest. This suggests a significant lack of awareness of the schemes available to the SME market, a

[1] "Risk in Emerging Markets" – McKinsey & Company, June 2014. http://bit.ly/1ct8ObV;
"Incorporating Qualitative Information for Credit Risk Assessment through Frequent Subtree Mining for XML" – Ikasari, Hadzic & Dillon. http://bit.ly/1HbQui8

[2] The 2014 Growth Accelerator report is included in this submission as an additional document. It can also be viewed at: http://bit.ly/1Iwu6TQ

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challenge which the European Investment Bank also addressed recently as it sought to build awareness of its own SME funding mechanisms through partner institutions throughout Europe.

Finally, our experience in delivering programmes such as the GrowthAccelerator in the UK has shown that businesses which receive external support have a greater rate of success in raising finance (attached); 46% of hyper growth companies sought finance advice from external sources to determine how best to expand and grow, compared to only 3% of traditional-growth SME employers. Management structures and internal expertise typically develop later than the business itself, so these businesses need help as they grow. We therefore recommend that in conjunction with the awareness-building efforts raised above, the Commission evaluate the role played by dedicated business support and investment readiness programmes in driving success in accessing financing for this segment of the market.

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

The Commission should consider three actions with regard to SME credit information:

- research the unique issues facing mid-sized businesses when considering credit solutions
- collaborate with the private rating agencies who have begun the work of developing mid-sized business (MSB) specific ratings models, as distinguished from small-sized business models
- consider utilising government-owned development banks and their national partners to provide consistent ratings for the small and mid-sized business market.

We understand that only one of the leading credit agencies has developed and marketed a dedicated product to provide ratings for MSBs. Even without a specific mid-market product, given the relatively low issuance of debt by MSBs, there are few ratings available for these companies across Europe. The result is MSBs find it more difficult to access typical bank financing than large corporates.

According to the World Bank's International Finance Corporation[3], more than 225,000 MSBs operate across the European Union. Research suggests that for these MSBs, access to bank lending, particularly for those who are part of a supply chain[4], is easier than for small enterprises, who far outnumber MSBs. However, there is a lack of data on the true impediments to credit for MSBs as compared to small businesses, a distinction we believe is important. Consequently the credit model for such businesses must continue to evolve for established MSBs who seek investment to expand to new markets, hire additional employees, and consider new product offerings.

The Commission should determine the data needs of investors in MSBs who are seeking finance. We find that those investors lack information on creditworthiness and risk for the mid- market and consequently there is a barrier to investment in these companies. To address the lack of mid- market information:

- the accountancy profession should be engaged to provide a comparative analysis of its aggregate data on the financial and non-financial attributes of successful mid-sized businesses and explore ways to work together with creditors, economists and others to develop appropriate risk models
- the Commission should bring together potential mid-market investors and economists to identify information needs
- separately, the commission should consider the evidence from developing markets[5] to identify non-financial data which inform lending decisions.

[3] World Bank's IFC Enterprise Finance Gap Database - Raw Data In 2010, IFC conducted a study to estimate the number of micro, small, and medium enterprises (MSMEs) in the world, and to determine the degree of access to credit and use of deposit accounts for formal and informal MSMEs. The study used primarily data from the World Bank Enterprise Surveys (ES). In 2011 the data was revisited as new enterprise surveys became available. The resulting database, IFC Enterprise Finance Gap Database, covers 177 countries.

[4] "Don't bank on the banks: small businesses seek alternatives as banks leave them in the lurch" The Economist, 14 August 2014. http://econ.st/XwU9Wf

[5] "Risk in Emerging Markets" – McKinsey & Company, June 2014. http://bit.ly/1ct8ObV;
"Incorporating Qualitative Information for Credit Risk Assessment through Frequent Subtree Mining for XML" – Ikasari, Hadzic & Dillon. http://bit.ly/1HbQui8

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Private enterprises have begun the work of creating specific MSB credit rating models, but the use is limited and MSBs typically do not acquire such a rating without issuance public fundraising. The EC may wish to understand whether MSBs raising finance from other sources could benefit from wider use of similar rating models.

Additionally, the accountancy profession is in a unique position to provide insight into the financial and non-financial attributes of successful mid-sized businesses throughout Europe. Operating on an aggregate basis, the profession's collective analysis would provide a window into the unique issues facing MSBs and could be a critical addition to the dialogue regarding creditworthiness and ratings solutions.

One final alternative is that government-owned development banks could provide ratings for MSBs. As an example, could the European Investment Bank lead an initiative to rate MSBs in partnership with national development banks? In Spain, for example, one of the companies that provides credit insurance is owned by the government and we believe that other similar companies in Europe could play a role in the development of ratings for MSBs.

Question 3: What support can be given to ELTIFs to encourage their take-up?

No opinion

Question 4: Is there any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?

No opinion.

MEASURES TO DEVELOP AND INTEGRATE CAPITAL MARKETS

Question 5: What further measures could help to increase **access to funding** and channeling of funds to those who need them?

The European Investment Bank (EIB) could address three issues which affect access to funding in the SME market.

1) **Deploy capital.** Though the EIB currently invests in SME financing through a variety of EU banking partners, there is an opportunity for the EIB to provide relatively inexpensive capital for investment alongside private sector funds. EIB funds would boost scale for existing investments, while simultaneously reducing the cost for new funds, with the effect of diversifying funding on equity and non-bank debt. The EIB has a record of successfully deploying capital in this way on equity funds but it would require further research as to the best structure to achieve the goals with regard to non-bank debt.
2) **Provide aggregation platform.** The market currently lacks an aggregation platform to bundle loans to MSBs and securitise them across the EU. The result is that European banks typically have significantly less capital available to lend when compared to their US peers. The EIB could provide such an aggregation platform.
3) **Consider co-investing in crowd funding platforms.** Finally, peer lending is a growing and important segment of finance for small businesses. As Grant Thornton UK shared in its Alternative Lending[6] analysis recently, the industry currently doubles in size each year in the UK alone; and more than 5,000 SMEs have raised funds through alternative finance intermediaries between 2011 and 2013. This growth is consistent with that observed in the Commission's latest report on crowdfunding across Europe, which found the European market grew more than 144% from 2013 to 2014, funding more than 10,000 European SMEs. Though the UK remains the leader in crowdfunding across Europe (more than 75% of all funding is driven from the UK), the market elsewhere in the EU is beginning to expand. However, with an estimated £107 billion SME funding

[6] FN6: For more information on Grant Thornton UK's Alternative Lending report, see the attached file or view the report here: http://bit.ly/11nGBO3

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gap in the next five years in the UK alone, crowdfunding could continue to play an important role in providing SME funding, particularly at the small and micro level. We suggest that the EIB play a role in the peer-to-peer market, by co-investing in crowd funding platforms to help stimulate the market, much as the UK government's British Business Bank has done recently.

Question 6: Should measures be taken to promote greater liquidity in the corporate bond markets, such as standardization? If so, which measures are needed and can these be achieved by the market, or is regulatory action required?

The development of a bond market for SMEs could be of significant benefit across Europe. As we now see in Spain, due to improved liquidity, Spanish banks are becoming more willing to provide all types of firms with credit. However, the structural issue facing the Spanish market is the relatively small role capital markets play in financing SMEs.

The issue of liquidity for such a bond market is a challenge. One solution could be to encourage the presence of market makers in these new markets. To do so, the Commission could consider adapting the collateral rules that the European Central Bank uses in order to provide liquidity. The adaptation would be designed to cover those bonds issued by SMEs and negotiated in the new bond markets. This would encourage the presence of market makers by ensuring that they will have enough access to liquidity at all times.

Another possible measure would be to engage the EIB and the government-owned national development banks to become active investors in the bond markets which have an SME focus.

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

No opinion.

Question 8: Is there value in developing a common EU level accounting standard for small and medium sized companies listed on MTFs? Should such a standard become a feature of SME growth markets? If so, under which conditions?

After more than 75 years of working with dynamic businesses around the world, we know that the lack of investment in MSBs is not a function of difficulty in applying accounting standards. Rather, it is likely that investors have not clearly communicated the information they need and rely on to assess the investment worthiness of MSBs. We recommend that the Commission explore with investors "what information investors need to make investment decisions?" That information might have a financial element, but may not be audited historical financial statements.

That said, as and when companies listed on MTFs are required to publish audited historical financial statements, at this time we see no value in creating a common EU level accounting standard for small and medium sized companies listed on MTFs. We present the following thoughts in support of our assessment that there is limited value in creating such a standard for companies listed on EU MTFs because we already have IFRS that does that job well because IFRS are scalable, and reflect the natural complexity of the business. We recommend instead the EU's efforts and resources would be better directed at supporting the IASB's Disclosure Initiative.

In responding to this question, we have considered:

- whether there is a need for a single harmonised accounting framework that applies to all small and medium-sized companies listed on MTFs in the EU; and
- if so, what that framework should be.

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We first considered the need for a single harmonised accounting framework for this market sector. In our view the EU's experience in the application of IFRS for the consolidated financial statements of companies listed on regulated markets clearly demonstrates that harmonisation has substantial benefits, and that these benefits outweigh any related costs in that market sector. However, we acknowledge that the balance between benefits and costs differs between larger and smaller listed companies. This is because, among other reasons, smaller listed companies may typically:

- have relatively fewer operations and activities outside their country of domicile
- have fewer cross-border investors
- face proportionately higher transition costs in switching accounting framework compared to larger listed companies.

We believe that more research is needed to assess the relative costs and benefits of harmonisation for this sector. In saying this we note that ESMA's database currently lists over 150 MTFs in the EU (although we understand that equity shares are traded only on some). Among these MTFs, some require the use of IFRS (such as AIM in the UK and ESM in the Republic of Ireland). Others require the use of national GAAP or offer a choice between local GAAP and IFRS. The variety of regimes in existence today may therefore provide an invaluable research source to help assess the advantages and disadvantages of alternative models. This research would preferably cover the characteristics of the companies as well as the needs of their investors and other stakeholders.

Irrespective of the relative costs and benefits of harmonised accounting requirements within this sector, we stress the importance of high quality corporate reporting by smaller listed companies. High quality corporate reporting encompasses both the historical financial statements and broader reporting on areas such as business developments, strategy, risks and corporate and social responsibility matters. In some ways we believe the role of the annual report and financial statements is even more significant in this sector than for larger listed companies. This is because, for smaller listed companies:

- investors typically receive fewer and less frequent updates on financial performance and other business developments from other sources and communication channels. Accordingly, they place more reliance on the annual reporting process;
- smaller listed companies with less sophisticated management information systems are more likely to generate information that is useful for management purposes solely as a consequence of the annual reporting process.

If it is determined that there is a need for a single harmonised accounting framework for all small and medium-sized companies listed on MTFs in the EU, the next question is what that framework should be. The Green Paper refers to a common EU level accounting standard. We do not support the development of a new set of EU-level accounting standards and believe instead that full IFRS is easily the strongest candidate. The main reasons are:

- there is currently no EU-level standard-setter and no institution that is equipped to take on that role. Putting in place the institutional arrangements would be costly and time-consuming
- historically, developing harmonised accounting requirements at EU-level in the detail necessary to achieve consistent, high quality financial reporting has proved challenging
- the creation of another set of standards for EU listed companies may lead to confusion among users and result in inefficiencies for all stakeholders in the financial reporting chain. The use of different standards between the EU's primary and secondary markets could also be a 'missed opportunity' to increase the level of interest from non-EU investors and from investors who currently focus on primary markets.

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Our strong preference is therefore for IFRS as the basis for harmonised accounting requirements, or at least as the starting point. This is for the following main reasons:

- IFRS is a well-established and widely understood set of standards, both in the EU and internationally
- IFRS is acknowledged to be a high quality set of standards, developed with robust due process
- we believe IFRS is suitable for all listed companies. Critically, we believe IFRS is 'scalable'. By this we mean that the complexity and volume of information resulting from the application of IFRS varies depending on the size of the preparer company and the complexity of its business. Accordingly, we think IFRS is sufficiently scalable to be applied by small and medium-sized companies listed on MTFs and that the resulting financial information is understandable to investors in such companies (although see our additional comments on scalability below). To illustrate this point we reviewed a small sample of IFRS financial statements prepared by companies listed on the UK's AIM market and noted that the typical length of these statements is in the range of 20 to 40 pages. Although this is a crude measure of complexity, it seems to us that this level of information is by no means excessive
- the institutional arrangements to develop (and, if applicable, endorse) standards are already in place. Accordingly, IFRS could be introduced as the basis for harmonised accounting requirements among MTFs relatively quickly and easily
- IFRS has the advantage of the availability of a large pool of suitably qualified and experienced finance professionals, both in the EU and internationally. These professionals also benefit from working in an area with international demand and consequent mobility.

That said, our support for greater use of IFRS among MTFs is not unqualified. We are of course aware of, and largely agree with, widely-held concerns around so-called 'disclosure overload'. We note that the IASB undertaking a number of initiatives aimed at improving the effectiveness of disclosures in IFRS, collectively referred to as the 'Disclosure Initiative'. We believe the Disclosure Initiative has significant potential to further enhance the scalability of IFRS and that meaningful progress in this direction would considerably strengthen the case for wider use of IFRS among MTFs. We also note that many other stakeholders, including accounting enforcement bodies and indeed audit firms, have a part to play in addressing actual or perceived disclosure overload.

We therefore recommend that the EU's efforts and resources would be better directed at supporting the IASB's Disclosure Initiative than establishing a new EU-level accounting standard.

Question 9: Are there barriers to the development of appropriately regulated crowdfunding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

Grant Thornton UK's recent experience working with growing mid-sized business BerryWhite is an excellent example of the increasing importance of crowd-funding to the mid-sized business market. As its owner explains in this video, the ease of accessing financing in the UK through this vehicle helped the company with important branding and expansion plans and it now operates in more than 30 countries around the world. You can learn more about BerryWhite's experience using crowdfunding here: http://bit.ly/1EBgGyB.

Replicating such a success across the EU requires attention to two barriers which the Commission could address:

- Regulatory regimes which prevent expansion of platforms across borders; and
- The lack of a secondary market to maximize the impact of crowdfunding and peer to peer platforms.

While the alternative finance market - including peer to peer and crowdfunding - continues to grow, there are significant variations in the regulation of providers across Europe. The UK represents the largest

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share of alternative finance use across the EU[7], but research has proven that the alternative finance market is a growing and important source of finance in developing markets as well[8]. However, with specific attention to the question of crowdfunding and peer-to-peer lending, there remain significant variations in regulation across the EU, and as a result lenders are not able to take advantage of investment opportunities in neighbouring markets without exposing themselves to regulatory risk.

We recommend the commission consider common rules which will allow the developing finance markets to continue to grow, while balancing such a regulatory regime with the need to provide investor protection.

Another barrier is the ability to maximize crowdfunding portfolios that could be addressed with support from the Commission. Whilst crowd funding, often cash flow based lending platforms, are perceived to provide an alternative to traditional bank lending, they do fill a gap (created when a low or no-risk bank credit policy will not allow a bank to invest), and provide an alternative source of finance , particularly to start-ups.

However, these platforms, at an individual deal level, are short of the scale investors in capital markets traditionally seek (and investor appetite has not yet been tested in a market where growth is negative). That said, there could be a block investment opportunity. With sufficient standardization, participation, and liquidity, a secondary market could be created for this debt at either the individual or, more likely, at portfolio level. Such a secondary market would provide investment level and revenue opportunities for other investors whilst negating the need to develop an SME lending infrastructure (allowing such investments to remain cost-effective and managed by an appropriately sized alternative provider.) We recommend that the Commission encourage standardisation, participation and liquidity, as further outlined elsewhere in this consultation. The greatest gains are likely in participation and liquidity.

Question 10: What policy measures could incentivize institutional investors to raise and invest larger amounts an in a broader range of assets, in particular long-term projects, SMEs and innovative and high-growth startups?

We acknowledge that the Commission wishes to encourage greater investment from institutional groups (e.g. pension funds, global asset managers) as opposed to individual angels, venture capital funds, and EIS funds with high net worth clients. We note that the incentives are different for institutional investors and that there will always be a challenge to provide access to the smaller end of the market at an affordable transaction cost. We recommend that the Commission consider two examples of policy measures which may support the engagement of these larger investor groups.

One example of a strong investment which has incentivized institutional investors is the UK's Enterprise Finance Guarantee (EFG), which has helped to address the typical lack of security available to MSBs, with £2.45bn lent under the scheme by the end of 2013(see presentation attached). Citing a recent summary from the British Business Bank, the EFG:

- stimulates provision of debt finance to SMEs by providing a guarantee to the lender where the SME has a viable business plan but isn't able to offer sufficient security (or lacks the history) to meet the lender's normal security requirements
- operates as a niche intervention, supporting additional lending rather than replacing finance which would otherwise be provided commercially
- is often used as part of an overall package of finance put together for a borrower.
- is only used when the lender can certify that an otherwise strong commercial proposition would not proceed due to the complete absence or inadequacy of available security.

[7] "Moving Mainstream: The European Alternative Finance Benchmarking Report" – University of Cambridge & EY, February 2015. http://bit.ly/1L0nds6
[8] "Global Financial Stability Report: Risk Taking, Liquidity and Shadow Banking – Curbing Excess While Promoting Growth. Chapter 2: Shadow Banking Around the Globe: How Large, and How Risky?" International Monetary Fund, October 2014. http://bit.ly/1H1OjLA

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The British Business Bank has launched a number of initiatives to help raise finance in the SME sector. The Commission may also have seen the work of KFW Group, providing domestic promotion, export and project finance, and development finance with particular benefit to the German SME market, which has often been cited as an example of good practice.

In the United States, the federal government has long provided "community investment credits" which provide tax breaks to investors who fund MSBs. The New Markets Tax Credit programme was established in 2000 with the aim of increasing investment in particular markets which needed reinvigoration, under the premise that investing in low-income communities results in higher job growth and enables entrepreneurship in those communities.

It is a certification programme by which Community Development Entities are reviewed and approved, and who then invest directly in projects and enterprises in the affected communities which in turn, meet its criteria. The credit (39% of the investment, paid out at 5% in the first three years, and 6% for the remaining four years) drives investment in low-income communities and enables investors to support meaningful change using market behaviours.

In the United Kingdom, the Enterprise Investment Scheme provides tax credits to individual investors who directly invest in SMEs. Though the programme has had a low take-up, there are likely lessons to be learned from this programme. One lesson is that these programmes need better promotion.

Question 11: What steps could be taken to reduce the costs to fund managers of setting up and marketing funds across the EU?

No opinion

Question 12: Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets? If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?

No opinion.

Question 13: Should the introduction of a standardized product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

No opinion.

Question 14: Would changes to the EuVECA and EuSEF Regulations make it easier for larger EU fund managers to run these types of funds? What other changes if any should be made to increase the number of these types of fund?

No opinion.

Question 15: How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

No opinion.

Question 16: Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

No opinion.

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Question 17: How can cross border retail participation in ECITS be increased?

No opinion.

Question 18: How can the ESAs (European Supervisory Authorities) further contribute to ensuring consumer and investor protection?

No opinion.

Question 19: What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

Providing access to investment funds regardless of geography could help spur retail investment. To do so, the Commission may wish to consider whether a pan-European platform could be used to allow retail clients to easily buy or sell investments.

Question 20: Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

No opinion.

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

We support the continued development of regulations which address structural issues relating to the markets; and which balance the need for risk management with the need for investor protection.

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

No opinion.

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

No opinion.

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

No opinion.

Question 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?

We do not believe that consistent supervision would significantly free up capital flows to MSBs. We believe that Commission focus will be more productive elsewhere.

Question 26: Taking into account past experience, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets within the EU?

No opinion.

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Question 27: What measures could be taken improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?

No opinion.

Question 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?

We do not believe that company law or corporate governance are significant impediments to investment in MSBs.

Question 29 – What specific areas of around insolvency laws would need to be harmonized in order to support the emergence of a pan-European capital market?

As a general principle, we support harmonised insolvency laws across the EU. However we perceive there is little prospect of success in this area, and suggest the Commission's efforts may be better rewarded elsewhere.

Question 30 – What are the barriers around taxation that should be looked at as a matter of priority to contribute to a more integrated capital market within the EU and a more robust funding structure at company level and through which instruments?

We believe there three taxation barriers which should be considered by the Commission as the CMU is developed:

- withholding tax on capital and income payments, treaty entitlement and reclaims process
- differential tax treatment on debt, equity and hybrid instruments
- financial transaction tax.

Withholding taxes: The operation of varying degrees of withholding taxes on dividend and interest payments across many jurisdictions leads to distortion of the after tax return on investments. Similarly many countries operate differing criteria to access treaty benefits. The administration of the withholding tax reclaim process and the speed and efficacy of tax authorities in dealing with reclaims also differs widely from country to country. Furthermore enforcement action has had to be initiated in various EU countries to achieve compliance with EC principles following a number of CJEU cases on withholding tax. The continued stance of some domestic tax authorities on withholding tax appears contrary to common market principles. Uncertainty surrounding entitlement to withholding tax exemption is an impediment to cross border investment. Ideally to facilitate a CMU, capital and income payments should be free from withholding tax; additionally, a common and simplified administrative process for establishing treaty entitlement and facilitating withholding tax reclaims would be helpful.

Differential tax treatment of equity, debt and hybrid instruments: Differential tax treatment in varying jurisdictions of equity, debt and hybrid instruments for investors may distort the efficiency of instruments for investors and consequently their commercial appeal. There may also be different tax outcomes when investors invest directly into an asset class as opposed to through a pooled collective investment scheme which inhibits cross border pooled investment. Similarly when the returns from pooled investment structures are reported to investors a number of countries for example Germany, Austria and the UK have different tax rules that the pooled investment structure must comply with to report the correct amount of income for tax purposes in each of those countries. This represents an additional cost and administrative burden for funds who may have to comply with 4 or 5 different reporting regimes across the EU. A common EU reporting framework for pooled investment structures would be a welcome development.

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Financial transaction tax: Financial transaction tax (FTT) is a significant barrier to CMU in that FTT increases the cost of capital and disadvantages savers and investors depending on the structure and location of the investment. FTT also has the potential to apply at multiple levels in a transaction chain which may increase the cost of capital further.

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Appendix I: Grant Thornton on the CMU

As an organisation focused on helping dynamic companies unlock their potential for growth, Grant Thornton is familiar with the challenges facing growing businesses. With more than 50,000 member firm clients operating across more than 130 markets, Grant Thornton member firms are addressing issues which impact clients' growth. Access to finance remains one of the core challenges for these companies, regardless of where our firms and their clients do business.

According to recent World Bank data, more than 225,000 mid-sized businesses (MSBs) operate in the European Union, generally employing between 50 and 250 people. Grant Thornton is familiar with the challenges these companies face, challenges which reflect the dual track recovery across Europe.

Specifically, we have observed:

- lending conditions in Germany, the UK, and France are still tough but appear less stringent than those facing growing companies in Greece, Spain, and Italy.
- larger businesses generally find it easier to access finance than smaller MSBs
- companies operating as part of an established supply chain find it easier to secure capital.

The most striking of these challenges, particularly for growing MSBs who are regularly engaged in exporting goods or services, is that similarly positioned businesses in Germany, France and Sweden are far more likely to obtain capital than their equivalents in Spain, Italy and Greece. In a recent Grant Thornton International Business Report survey, 35% of southern European businesses cited access to finance as a growth constraint, compared to just 22% across the EU as a whole (and just 14% in North America).

This is not primarily due to a higher risk thresholds at the banks, but rather that there is limited lending capital in these markets. In the wider view, the challenge for MSBs is that even when bank capital is readily available, access to the equity capital markets is not a feasible option.

There is limited data on the impact of these MSBs to the European economy[9]; yet we know that MSBs are critical to the health of any economy because they are trading, expanding, hiring, and developing new products. To mobilise substantial funding across Europe in to both the MSBs and SME market requires fresh thinking and a capital market that (i) delivers what finance providers state they need to make informed decisions, (ii) is clearly recognised and understood by those seeking capital and (iii) is structured to allow bundling, securitisation, secondary markets to deliver efficient investment flows.

Delivering information providers need to expand access to finance

CMU represents a critical opportunity to expand access to finance to the MSB market segment. However, the needs of MSBs differ significantly from those of the micro and small businesses although they are frequently pooled together. Conversely, information needs from providers do not currently align with information made available from the MSB segment.

[9] Most available analysis merges the impact of micro, small and medium sized businesses; a notable exception is the recently released report "Hidden Impact: The Vital Role of Mid-Market Enterprises" HSBC Bank Plc, March 2015. http://bit.ly/1H1QTRR.

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We recommend that the Commission consider a study to assess the specific needs of dynamic MSBs, because these companies will be the primary drivers of Europe's growth.

Further, we recommend that the accountancy profession leverage its unique insight into the mid-sized market and support the provision of an aggregate view of financial and non-financial characteristics of successful mid-sized businesses across Europe, using its combined data and analytics power to support risk and credit insights for this market.

Creating an environment for growth

Grant Thornton UK's work with the Growth Accelerator business support programme has shown us that high growth companies succeed when they work closely with business advisors and consult with experts to understand and access the best finance options. Success is also more likely when growing businesses access government-backed programmes dedicated to these businesses – however, there is low awareness of these programmes generally, including current programmes in place across Europe. We recommend the Commission consider such programmes as an important part of the execution of any capital markets strategy with small and mid-sized businesses as beneficiaries. Further, we recommend that the Commission focus on awareness building of existing programmes as an immediate priority to help support the growth of these businesses while the CMU is in development.

Simple and consistent tax incentives and tax treatment

Finally, we recommend simple and consistent tax incentives and tax treatments be made available across Europe, as investors will have an important role to play in the success of the CMU.

The Capital Markets Union is a programme with significant potential to benefit small and mid-sized businesses throughout Europe. As the major capital markets continue to improve, it is possible to envision capital again flowing freely to large corporates, with small and mid-sized businesses left without access. We encourage the Commission to hold to its vision for the long term structure and intent of the programme, and deliver a CMU that will support Europe's growth for the future.

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