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Submitted online and via email to:
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Dear Sir,

European Commission Green Paper on Building a Capital Markets Union

I am writing on behalf of KPMG's European practices in response to the Green Paper on Capital Markets Union.

As a global professional services network with a strong European base, we are keen to play an active role in supporting the European Commission in its objective to strengthen and deepen Europe's capital markets. We believe that we are well-positioned to do so given the breadth and depth of our business and industry expertise, including our strength in financial services and our expertise in areas of crucial importance to effective capital markets, including corporate reporting and accounting, corporate governance, the analysis and presentation of financial and non-financial data and our core skills of validation, including assurance and auditing. We have an active presence in all of the EU member states and strong global practice links to draw upon.

In summary...

- We fully support the goals and overall approach, in particular the emphasis on industry-led solutions rather than purely legislative measures.
- Our core skills in preparing, presenting and validating data are at the core of building more effective capital markets.
- Our recommendations focus on the key issues we think should underpin the Capital Markets Union:
 - **Creating an investment culture:** make the regulatory framework more balanced and cohesive; differentiate consistently between types of retail investor; improve the relevance and clarity of corporate reporting.
 - **Enhancing market operation:** create a Capital Markets Stakeholder group; develop an appropriate framework for securitisations; develop infrastructure investment further; encourage investors to provide more long-term funding.

Continued...

- **Unblocking savings and savers:** boost the role of retail investors; support ESG investment; understand role of **tax** on investors and investees.
- **Building the right infrastructure:** share best practice on corporate governance; simplified prospectus **directive**; industry-led capital markets data initiative; increase cooperation between market supervisors.
- **Encourage business engagement:** simplified corporate reporting model; strengthened framework around credit information.
- We also include six detailed tests that we consider should be applied to any detailed proposals and /or recommendations.
- We intend to adopt a highly proactive role going forward in the market to support the development of industry and policy based solutions. We will share such outputs with the Commission.

Context to the Green Paper and overall comments

We agree the issues raised in your paper are of fundamental priority for the European Union. The rationale for action is clear; credit markets are suppressed, twenty four million people are unemployed and youth unemployment is running at unacceptably high levels in many countries, action is required to deliver sustainable economic growth and boost job creation. The size of the European banking sector is large compared to our national economies. Capital markets union presents a rebalancing opportunity, to grow the capital markets while maintaining the role of banks as both providers of credit and intermediaries between investees and alternate providers of debt and equity finance.

We see the opportunity within the capital markets union initiative to support other policy priorities including business competitiveness, boosting investment and savings, increasing transparency and good corporate governance – all of which have far reaching implications for our clients and we see this in perspective with the work KPMG does in the wider economy.

We welcome the Green Paper and notably its inclusive approach with an expectation of industry-led analysis and solutions rather than detailed legislative, regulatory or supervisory measures. We see great potential benefits to individual citizens and wider society.

In this response we set out our initial views on a number of issues in the areas of our expertise. We have consulted within our member firms and practices to draw upon the expertise across the whole range of our business activities. We are happy to develop these ideas further, and others that may arise in the course of this consultation, in cooperation with the European Commission and other stakeholders.

Stronger capital markets can make the financial system more resilient and efficient. We recognise that political and technical obstacles will emerge, and be challenging to resolve as there is considerable variation between countries in the EU in the ability to effectively provide finance to SMEs and other businesses. In overcoming those obstacles, solutions must be found for all twenty eight Member States and should contribute to achieving as much consistency as possible with international standards that emerge from bodies such as the IASB, BCBS, IOSCO, IAIS, FSB and ultimately the G20.

Financial stability is vital as it provides greater certainty to investors both in Europe and internationally. But measures taken to achieve stability must be balanced with those that are necessary to remove the barriers and disincentives which are preventing a greater flow of investment across borders within Europe and inward investment from other parts of the world. The EU capital markets union must be about both facilitating the operation of the internal market as well as attracting international investors into Europe.

Achieving growth means businesses recognising and embracing the risk / reward ratio. This will need increased levels of transparency, control and oversight to be in place. Independent assurance providers have a unique role to play here – the preparers and providers of information need clear, internationally consistent reporting standards to comply with and users, the investors, need to have confidence in the reliability of the information provided. As an assurance provider and business advisor we also have an important role to play, helping to build trust in the capital markets, enabling our corporate and financial services clients to grow, be successful and develop viable business models. We believe the most promising potential lies with both high-growth companies which lack access to risk capital and with medium-sized companies which struggle to meet the hurdles required to access markets directly.

We see five areas for early action with quick wins as well as a series of more complex issues that will need further analysis and discussion with a broad range of stakeholders. We explore these in our response below and also in the online questionnaire where appropriate.

Firstly, however, we offer a series of tests which can be used to assess the ideas which flow from these key areas - tests that need to be applied to any recommendation to create a more effective European capital market.

Tests for the development of policy to build a Capital Markets Union

1. Capital markets support wider EU agenda priorities including digital and infrastructure

Recognising the work already underway in the European Commission on the wider social and economic agenda, capital markets union needs to support and reinforce those wider aims and objectives. On infrastructure Europe already has some success at combining public and private finance in large and complex projects. But more could be done and greater incentives given to build on the seed funding that the European Fund for Strategic Investments is intended to provide. The linking up of investment planning and funding options across major EU agendas such as energy, transport and telecoms would help to create confidence to investors that there is a credible coherent long-term plan.

2. Enterprise finance becomes more dynamic

Europe has a long tradition of banks meeting the credit needs of business finance, and also holding large amounts of savings in cash on deposit. To get finance flowing into Europe's economy, the perception that banks are the only place for savings to go needs to change, especially given the relative safety and protection that investment vehicles such as UCITS funds offer – and which despite their strong international brand have seen inconsistent take up across much of Europe. Backed by the right incentives and protections, other forms of finance could develop from securitisation, private equity and corporate finance. Coupled with a simplified prospectus process reducing the cost for SMEs, these could provide more options to bring those needing investment together with those wanting to invest.

3. Make regulation clearer and more consistent

Markets are rightly highly regulated to protect consumers and investors, while this helps give confidence to market participants it also adds cost and complexity. A more holistic vision for financial regulation is, however, urgently needed; in the post-financial crisis years multiple regulatory initiatives have resulted in a complex patchwork of different rules across markets and financial services firms. Often a worthy goal such as increasing transparency, when tackled in isolation from different angles, can lead to additional unnecessary reporting requiring vast amounts of data – the resulting increased cost of compliance depresses market activity. For smaller enterprises (where jobs can be created more easily) this will act as a barrier to participation in capital markets activity.

4. Tax systems are made more consistent, transparent and effective

Greater consistency of the tax system for private, collective and institutional investors, as well as for the investee companies to make long-term plans and decisions is needed. Although a difficult topic to tackle under EU law, the goal should be to aim for as much consistency across countries as possible. Consideration should be given to ways of addressing the biggest barriers to investment flows through the use of enhanced cooperation procedures and a deeper analysis of tax barriers, incentives and disincentives for investors. Globalisation is a reality for all business, large and small whose activities are not confined by national borders. Projecting today's business reality on to the patchwork of differing national tax rules inevitably gives rise to complexity and anomalies.

5. Corporate governance frameworks are made more solid

Investors want greater confidence in the companies they are investing in including the information on how those businesses are run. Transparency of governance and decision making is critical to give a clear picture and enable comparison to others. Creating more transparency, without adding unnecessary costs and burdens on businesses, helps investors and has wider societal benefits. Given the varying starting points and business cultures in different countries, approaches should focus on encouraging adoption of best corporate governance practices rather than imposing one size fits all regulatory requirements.

6. Information is made more transparent, reliable and comparable

Encouraging investors from one country to invest in another requires high quality information. Underpinning efficient and effective capital markets is the provision and availability of high quality, reliable data to enable investors to make decisions. Demanding standards are today in place for larger corporates seeking to raise debt or equity on the markets; careful calibration of existing requirements will be needed to lower the barriers to entry while at the same time maintaining quality standards in order to widen access to the markets by smaller businesses.

Key issues and areas for action

We summarise five areas which we believe should underpin the development of the European Commission’s capital markets union action plan and within each our initial thinking on changes that could be considered. We have attempted to answer most of your questions but our structure has varied slightly to help our analysis and thinking.

1. Creating an investment culture



Europe needs to develop a culture where long term private investment throughout citizens working life and into retirement is seen as the norm. We face demographic challenges from an ageing population and ever-increasing demands on the public finances. Expected long-term low interest rates means savings in deposit account accounts are seeing little growth, and it seems that citizens have not fully understood the implications for their personal circumstances in the long-term. The awareness, experience and attitudes to investment varies greatly across Europe, so more positive reinforcement that investment is a positive thing would be helpful. Governments could be encouraged to do more with targeted policies to encourage a willingness to invest (via equity or debt). This could include financial literacy education, appropriate fiscal measures to encourage the initial investments and incentives to hold investments for the long-term.

Regulation can both help and hinder. The right levels of investor protections give retail investors greater confidence to move from cash-deposit savings into investments. Equally some of the filters in place to protect investors need to be calibrated to balance protection with incentives.

Europe’s businesses also need a culture shift to accept the greater levels of transparency and disclosure that potential investors will want. Providing more relevant, reliable information that has been validated by independent third parties and which is presented on a basis that enables comparison to other businesses is key to making a business attractive to investors.

Policymakers will have to balance the possible tension between further regulating ‘shadow banking’ while also encouraging more market-based finance at the same time, as they could often be the same things seen from different perspectives.

Actions which could help create a stronger investment culture are:

i) Make the markets regulatory framework more balanced and cohesive

- The post crisis response was to ‘regulate everything’.
- Disincentives and costs are now discouraging innovation and risk-taking.
- Markets are harmed by inconsistent rules designed to tackle similar issues, for example investor protection within AIFMD, MiFID and UCITS.

Quick wins could include:

A deep and comprehensive assessment of market rules to map a series of adjustments tested against criteria including; do the rules:

- *Promote proportionate levels of stability for the markets?*
- *Encourage EU investors and investees into the market?*
- *Promote Europe’s capital markets and encourage international investment into the EU?*

ii) Differentiate consistently between types of retail investor

- Getting investor protection levels right is crucial for restoring confidence and boosting levels of investment.
- Currently small savers have varying levels of protection compared to wealthy ‘semi-professional’ investors.

Areas for early action could include:

- The rules for European Long Term Investment Funds sets a higher bar for retail investors compared to EU Social Investment Funds or European Venture Capital Funds.
- Definitions could be made consistent and improved through adjustments to MiFID.

iii) Improve the relevance and clarity of corporate reporting

- Transparency and clarity in company reporting is key to creating confidence.
- Greater stewardship transparency is in the long-term interests of the economy.
- If companies and their shareholders are positively engaged, then governance and long-term investment would benefit.

Industry and standard-setters could work together to:

a) Provide investors with more meaningful information:

- Encourage a more holistic approach to the corporate reporting model, focusing on the key areas of interest for the investors (thereby simplifying the reporting requirements) as opposed to adding to the current patch work of disclosure and reporting requirements and leading to further complexity.
- The annual accounts and the auditors' report must contribute to building a solid foundation of trust with investors; for example KPMG in the UK has field-tested new, more informative, long-form audit reports¹ with success and this has been widely acclaimed by investors and stakeholders.

b) A simplified long-form corporate reporting model could be developed for smaller companies to provide investors with the value of additional information without adding unnecessarily to costs.

2) Enhancing market operation



Financial markets have undergone a significant regulatory and supervisory reform programme since the financial crisis. Many of these proposals and initiatives were absolutely necessary. But uncertainty about where regulatory reforms will end is not helping these markets play a greater role in economic recovery.

Given markets are global in nature, EU-specific regulation must not discourage investment from outside Europe nor place EU businesses at a competitive disadvantage compared to international counterparts.

Essential to the efficient operation of capital markets is the ability of investors to exit a primary investment into the secondary markets, thereby creating liquidity and broadening the benefits of investment. Any proposals that seek to reshape market operations which are under consideration by the FSB in recent papers and by UK authorities under the Fair and Effective Markets Review need to balance the impact on market operations with the desire to drive out misconduct. Early engagement in these reviews at the EU level, as part of a global response are to be encouraged. Wrong policy decisions in this area could adversely affect jobs and growth.

¹ www.kpmg.com/uk/en/issuesandinsights/articlespublications/newsreleases/pages/kpmg-announces-radical-new-approach-to-audit-reports.aspx

Some areas for early action include:

i) Create a Capital Markets Stakeholder Group

- Markets have many participants across investors, investees, financial and associated professional services.
- A more holistic view is needed as proposals and ideas develop for the efficient and effective running of markets in Europe.
- An example model for effective collaboration would be the industry stakeholder group set up alongside the Fair & Efficient Markets Review in the UK, where a practitioner panel has added considerable value.

Features of a Capital Markets Stakeholder Group would include:

- a) The creation of an open dialogue involving industry, user representatives, standard-setters to identify where unintended inefficiencies have occurred and identify how best to mitigate them.
- b) Closer working within the European Commission's Better Regulation agenda.
- c) Supporting the cumulative impact review of post-crisis financial regulations.

ii) Develop an appropriate framework for securitisation

- A clearly identified problem before the financial crisis was complexity of tranching in securitisations.
- To attract investor appetite a more flexible prudential risk approach is needed that distinguishes between the risk profiles of different qualifying securitisation positions to ensure these are appropriately calibrated relative to other investment alternatives.

Actions which would help include:

- a) A revised framework should include independent verification that prescribed qualifying criteria have been and continue to be met as part of improving transparency and comparability.
- b) A framework based on issuer verification may not meet investor internal risk assessment requirements. Investor determined verification may result in differentiated assessments being made, in relation to the same qualifying securitisation, potentially adding complexity to subsequent secondary market trading of positions.
- c) Existing rules that create disincentives need to be identified and addressed in the revised framework. For example, investment managers are restricted in their holdings of securitisations, the so called 'skin in the game' material economic interests requirements to a greater degree than the issuers (banks) – due to the threshold being copied across and hardwired into AIFMD level 2 text from the then EBA guidelines, which have since been adjusted.

- d) A relatively quick win would be to treat high quality securitisations in the same way as covered bonds in capital and liquidity requirements for banks, with the capital implications of holding such assets also reassessed on the buyers' side (other banks and insurance companies).

In some countries covered bonds have been effective and there seems to be merit in assessing their potential use beyond the mainly mortgage assets they are currently associated with.

iii) Develop infrastructure investment further

- Infrastructure investment supports growth in the short-term via “multiplier effects”. It also boosts productivity in the long term by raising the capital stock of an economy, improves the allocation of activity and promotes competition as well as the diffusion of technology and organisational practices.
- The biggest challenge is how to pay for these infrastructure needs. This has two parts – funding and financing. All infrastructure assets are ultimately funded (paid for) by either user charges or via the host Government tax revenue. Some areas of infrastructure, such as water and energy, are largely funded privately via levies on consumers whilst others, such as transport, are funded by both public and private sources.
- In the years immediately post the crisis, the role of the EIB was critical to maintain the supply of finance. However, over the past twelve months there has been a strong recovery in the liquidity and pricing of infrastructure debt and there has been a strong recovery from a number of commercial banks and the important emergence of institutional investors. This institutional model has also been stimulated through the development of the EIB Project Bond Credit Enhancement initiative.

Actions that could be taken include:

- a) The European Fund for Strategic Investments (EFSI) aims to stimulate infrastructure investment across Europe. However, the projects selected may not be constrained by lack of finance alone but may also have issues in relation to their risk profile and funding sources – i.e. how they to be paid for.
- b) To maximise the liquidity in the market, Europe should provide the regulatory support to institutional investors to encourage infrastructure as an investment class. Furthermore, the EIB can play a key role in supporting the development of the institutional debt market through its products such as PBCE and the credit enhancement product proposed under EFSI.

iv) *Encourage investors to provide more long-term funding for infrastructure investments*

- Insurers and other investors have a vital role to play to match the long term liabilities they manage to long term asset classes such as infrastructure investments.
- Regulation has unintentionally limited their scope for holding these assets on their balance sheets.

Actions to address include:

- a) Although Solvency 2 adjustments have lifted some restrictions on long-term infrastructure investment, this could be taken further by reducing the high capital charges applied to longer duration and lower rated investments, and to unlisted equity.
- b) Ensuring that insurers are not penalised by the application of a look-through approach to investment in collective investment schemes such as ELTIFs.
- c) Greater recognition by supervisors of the difficulties in obtaining sufficient data for the use of internal models in these types of investments.
- d) Relaxing the requirements on asset and liability matching (because infrastructure investments tend to generate no income stream in the early years, with an uncertain level and timing of returns thereafter).
- e) Reducing the requirement for a “prudent” limit (currently usually 10%) on investments that are not traded on a regulated financial market.
- f) Allow infrastructure investments to be tranching with junior claims being more equity-like and thus potentially more attractive to hedge funds, while senior tranches could be structured to be more bond-like (with lower but more regular returns and with more scope for external ratings).

3) Unblocking savings and savers



Bringing some of the dynamism and entrepreneurial spirit of the US capital markets to Europe referenced above in the ‘creating an investment culture’ section, means a fundamental change in attitude from seeing cash-deposits in banks as the only ‘safe’ place for savings towards more individual or collective investments.

The tendency of Europe's savers is to hold cash deposits. This has been reinforced in the years since the financial crisis. Banks have been told to rebalance funding from wholesale to retail deposits, and customers are attracted by deposit protection notwithstanding low interest rates. These circumstances have led to a higher bank savings profile in Europe as compared to other jurisdictions.

Different countries are in different places on pension provision and long term investing with different legacy systems and cultural considerations. The underlying differences in tax regimes and solvency legislation creates disincentives for any cross-border developments.

A key goal of Europe is to support sustainable and green investments which could also be included so the increased flow of investments support wider goals.

Actions to help unblock savings and savers include:

i) Boosting the role of retail investors

- The size and structure of Europe's banking sector is undergoing significant change as balance sheets and business models adapt to the new regulatory and supervisory environment.
- Banks need to be incentivised to widen the choices available to investors.
- Lack of awareness amongst investors of alternative options for investment (either debt or equity) and how to access such opportunities.

Medium term progress could be achieved by:

- a) Creating a European Retail Investment Taskforce to look at better educating citizens into the dynamics, risks and benefits of investments with recommendations for targeted incentives including tax to increase uptake, for example as is given to venture capital investments.
- b) Encourage greater certainty over long term investments - some interesting ideas to be considered include the use of a '29th regime' to overcome national differences and barriers within a common framework. A more detailed analysis of barriers would be helpful in this respect including the need for national governments to move towards more convergence while recognising their need to control taxation.
- c) Encouraging banks to explain to customers with significant cash balances that there are alternatives to longer dated deposits which could yield better returns without significant extra risk using collective vehicles.

ii) Supporting Environmental, Social and Governance (ESG) investment

- The EU should support the development of ESG guidelines within the market including helping ensure there is one recognised standard.
- Currently both Green Bond Principles and Climate Bond Standard are in development; these should be used to drive additional investment in ESG/green projects supporting a low carbon, responsible economy, and not just to re-badge investments which would have occurred anyway.

Quick wins could be achieved through:

- a) Combining/aligning the requirements to aid consistency and simplification.
- b) Enforce the guidelines which are being developed, ensuring companies and bodies are obliged to comply with such standards if investments are to be deemed as an ESG or green investment. This could be achieved by obtaining commitments from Member States.

iii) Understand the role of tax on investors and investees

Whilst a vital part of the economy, tax can act as a significant disincentive to cross border investment and skew investment decisions. Issues requiring consideration in creating a Capital Markets Union include:

- Whether it is possible to achieve a more consistent basis of corporation tax across the EU removing inequalities between businesses resident in different member states.
- Achieving harmonised VAT treatment of financial products across the Union.

Consideration should be given to:

- a) Taxing investment returns on the same basis internationally (e.g. capital vs revenue and special rates of tax).
 - Removing withholding taxes or ensuring that all withholding taxes imposed apply equally for all investors, including, where necessary, streamlined procedures for reclaim and/or credit including adoption of the OECD TRACE initiative.
 - Agreeing a common reporting standard for tax information reporting, possibly including the introduction of EU wide tax identification numbers.
 - Reviewing existing and proposed transaction taxes (e.g. stamp duties and FTT) to determine whether these would reduce the efficiency of the Capital Markets Union.

- b) The debate around tax is complex and often polarised. With this in mind, KPMG has launched a project “Responsible Tax for the Common Good”², which involves bringing together a wide range of stakeholders, including business, politicians, NGOs and ultimately the public, to discuss tax issues of the day. Whilst there is a place for working groups of technical specialists, which we would be very pleased to participate in, this forum allows for a way to assess whether proposed tax changes have wider political and societal support.

4) Building the right infrastructure



Encouraging investors to invest needs trust and confidence which is partly helped through access to high quality information. Underlying efficient and effective capital markets is the provision and availability of high quality, reliable data to enable investors to make decisions to invest or indeed divest from a company.

Rigorous and tested high standards are in place for larger corporates seeking to raise debt or equity on the markets. While attractive in prospect any widening of access to smaller businesses will need careful calibration of existing requirements to lower the barriers to entry while maintaining quality.

Considerable differences exist across countries in approaches to corporate governance and the levels of transparency over decision-making made by firms. Investors increasingly want to understand the way a company manages risk and assigns responsibilities.

Actions that would help include:

- i) *Share best practice in corporate governance and enhance board effectiveness*
- Strong corporate governance, transparency, high quality reporting and validation are inextricably linked.
 - The quality of financial information is heavily dependent upon the effectiveness of the corporate governance operating within a particular company.
 - Improving the quality and reliability of financial information on which investment decisions are made needs to be supported by a robust corporate governance framework.

² www.responsibletax.org.uk

A way to address this would be to:

- a) Demand greater transparency around the role and functioning of the audit committee.
- b) Improve disclosure requirements - while EU legislation already requires disclosure relating to “the composition and operation” of the audit committee, experience has shown that more focused disclosure has resulted in both better information disclosed to the market and improvements in the way audit committees actually discharge their duties.

ii) *Simplified Prospectus directive*

We summarise below our views in this area rather than providing detailed responses to the questions contained in the Green Paper.

- Early attention is needed to how prospectuses can be simplified to help widen access to the capital markets of firms seeking funding directly from the markets.
- It is important that high standards are applied to and quality assurance is obtained on the content of documentation used for marketing of securities.
- The required contents for such documents can vary depending upon perceptions of the needs of preparers and users, taking into account the type of security and the nature of the marketing.
- The vetting process of prospectus documents by competent authorities was supposed to not only check that required standards are being met but also to help development of common approaches and interpretations. In practice this hasn't resulted in sufficient clarity over the expected contents of prospectuses.

Enhancements in this area could include:

- a) Better cooperation and transparency across Europe between competent authorities over the expectations of offering documentation.
- b) A reduced regime for SME prospectuses has some attractions but would also carry the concern that detailed information is not only desirable for investor protection purposes but also to enable greater comparability across different firms.
- c) Consideration could be given to extending exemptions from competent authority approval and rely on legal compliance and market discipline to drive best practice.

iii) Industry-led capital markets data initiative

- Broadening access to markets will require creation of more transparent, reliable and comparable data.
- Currently there are numerous providers and solutions across Europe who could be encouraged to work together to create a common platform that both investee and investors can access cost effectively.
- Data including financial information, corporate reporting, credit scoring and payments information could all be brought together with common standards and approaches.
- Needs clever use of technology to intermediate investors and investees across border.

A possible approach would be:

- a) Encouragement and support for an industry-led working group to analyse current practices and where improvements could be made. This could sit within the Capital Markets Stakeholder group we have recommended earlier.
- b) Representation should cover the investee, investor, accounting, data-providers, credit-rating agencies and market analysts.
- c) Recommendations could combine industry-driven standards and best practices, backed where required with adjustments to the legislative framework.
- d) Principles of proportionality and alignment to international standards should be maintained.

iv) Increase cooperation between markets supervisors

- The European Supervisory Authorities have increased powers to write rules and technical standards.
- The volume of detailed technical regulatory measures and the complexity of how markets work makes it inevitable that many of the post crisis financial regulations will contain measures that if not carefully calibrated could harm developing the capital markets.

A possible approach would consider the following:

- a) There should be no need for a new edifice of regulatory roles to support capital markets union.
- b) The existing European Supervisory Authorities and global standard-setters must be encouraged to further cooperate and seek to use, harmonize and simplify existing standards and adopt industry solutions wherever possible.
- c) A formal mandate could be given to EU authorities to support jobs and growth as well as protecting consumers, investors and financial stability.

5) Encouraging business engagement



Relevant and reliable information continues to be at the foundation of ensuring trust and transparency in the market place. Divergent standards lead to market fragmentation and regulatory complexity, undermining European competitiveness.

To encourage businesses to seek alternative financing there needs to be a change in culture and attitude towards responsibilities, transparency and openness to providing information over and beyond the minimum requirements.

Significant investments have been made by Europe over the past ten years in IFRS and in their enforcement for the regulated markets.

More could be done to create greater collaboration and support for growing businesses. KPMG is involved in Entrepreneurial Spark³ the world's largest free business accelerator, helping deliver business advice and support to thousands of entrepreneurs across the UK. Across Europe there could be more support to build business investee communities with technology platforms using standardised accounting and reporting formats to reduce costs and potentially also generate benefits, such as businesses pooling their investment needs to raise funds from the market.

Steps that could be taken include:

i) Simplified corporate reporting model

- As the feedback to a recent EC consultation on the IAS Regulation showed, the introduction of IFRS for listed companies in the EU has contributed to more comparability and transparency of financial reporting by EU listed companies on regulated markets; as such, IFRS has facilitated foreign direct investment. Cross-border investment and listings by EU companies within the EU are facilitated by IFRS, thereby aiding the internal market in the EU.
- In addition, third-country companies can more easily access the EU capital markets, in particular if their own country has also adopted IFRS. For unregulated markets, there is a trade-off between investor protection and cost-efficient solutions, so as not to create entry barriers for target companies to list on those markets.

³ <https://www.kpmgenterprise.co.uk/news/kpmg-signs-deal-with-natwest-and-entrepreneurial-spark-to-support-start-ups-across-uk/>

- Current IFRS may not meet this trade-off for unregulated markets, because of its significant disclosure requirements and its complexity. Complexity is driven partly by more complex business models and transactions, but also by complexity in the IFRS requirements themselves, for example with respect to debt/equity classifications, accounting for share-based payments or annual goodwill impairment testing
- Generally, companies that are the targets for listing on unregulated markets are start-ups or smaller companies that lack the complexities in their business models and transaction structures compared to larger corporations.
- With a proportionate disclosure regime and ongoing simplifications in IFRS requirements, IFRS can in our view form a basis for a simplified corporate reporting regime for unregulated markets.

The way forward would be:

- a) Reporting in unregulated markets should build on IFRS as a globally consistent approach to establish a simplified corporate reporting mechanism appropriate for the variety of companies under this umbrella.
- b) The benefits of the adoption of a simplified, IFRS based, reporting model for unregulated markets would ultimately exceed the costs of implementation and ongoing maintenance, although we acknowledge that both are hard to measure objectively.
- c) The most significant benefits lie not in improved reporting processes or savings, but in improved transparency and comparability for investors.
- d) In the short-term, we urge the European Commission to engage with the IASB on their current Disclosure Initiative to find an appropriate balance between consistency in disclosures and relevant information, taking the materiality concept into consideration, in order to alleviate some of the burdens reporting under IFRS would currently bring to these companies.
- e) As a medium-term objective, we believe that there is a strong need to further develop the current corporate reporting model to improve reporting on key matters, of relevance to investors and other stakeholders, in particular with a focus on those non-financial performance indicators that are the true value drivers for the business in the medium to longer term (including operational measures such as customer loyalty or talent development and retention), and to consider the impact of technology on future reporting requirements. Such considerations should also consider the need for broader assurance on reported information most valuable to investors.

ii) *Strengthened framework around credit information*

- Credit scoring has been notoriously unreliable and significant effort is needed to understand a particular SME business in order to make a meaningful investment decisions.
- Investor and other stakeholders needs for independent assurance on value drivers that are currently outside of the traditional statutory financial statements need to be carefully considered.

Actions that would bring significant benefits include:

- a) Establishing minimum standards for SME credit information ensuring that credit information is good quality and informative.
- b) Create an infrastructure to ensure that the data may be shared would better enable investors to compare and assess SMEs.
- c) Encourage additional reporting best practices such as assurance over sustainability reports, regulatory reports provided by financial institutions to their regulators or reviews of interim financial reports – but there are others areas over which investors may value assurance on including SME credit information; payment performance, defaults etc.
- d) Expanded auditor assurance or a broader range of performance indicators would help build trust and restore investor confidence.
- e) KPMG in the UK is working with other commercial partners and Government on a ‘digital credit passport’ that would help package up information including credit data and financial information from SME’s into standardised formats that could be used by banks and potentially other investors to make credit decisions. Looking ahead potential for similar systems to connect together and be used for analytics to bring additional value and transparency to the markets. We would be happy to share our experiences with the Commission.

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In summary we see great opportunity within the capital markets union initiative on a broad range of issues, many of which are highly complex, that will need further studies, analysis and discussion between stakeholders. I hope you find our contribution constructive and useful and we would be happy to discuss any of the points in more detail and to contribute our knowledge and experience to the valuable work of the European Commission.

The jobs and growth agenda can best be delivered through the smaller and high growth enterprises in Europe. Both debt and equity financing will provide an alternative to the more traditional bank-led credit and this will suit the needs of entrepreneurs. We have a working group from across Europe who have contributed to this letter and this response is the beginning of our engagement on this topic. Capital markets union will be a significant catalyst for changing the functioning of the markets in which our clients operate – both for investors and for our corporate clients seeking to innovate how they raise debt and equity. These issues touch many parts of our firm and we will continue to meet to debate the issues with the key institutions and our clients in the coming months. As new issues and ideas emerge we will proactively share these with the Commission and stand ready to fully participate on any working groups that are established to address specific issues and recommendations that emerge from this consultation process.

If you have any specific questions regarding our thinking I would suggest you contact Giles Williams (giles.williams@kpmg.co.uk) in the first instance.

Yours sincerely,

John M. Scott
Chairman