ECMI ANNUAL CONFERENCE 2021

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The ECMI Annual Conference 2021 consisted of a series of three webinars focused on the European bond market, the private equity (PE) landscape, and the global uptake of crypto assets. Although the 2020 Capital Markets Union (CMU) action plan and the recent legislative proposal package adopted by the European Commission both, maintain the momentum on the CMU project, the fault lines in Europe's capital markets require much more decisive action by policymakers and regulators.

Bond markets have shown the way forward, with the increased direct issuance by the EU to finance the Recovery and Resilience Facility (RRF). An EU-blended bond, like the one offered under the Next Generation EU programme, seems to indicate the start of a European safe asset.

The boom in PE markets observed over the last few years demonstrates an appetite for risk-taking. However, the European PE and venture capital ecosystem is not completely self-sufficient, while regulatory barriers hinder its cross-border integration and development.

The growth of crypto assets highlights the need for both coordination at the international level and harmonised standards. The securities markets regulation can form the basis to resolving some of these issues, but significant gaps require more crypto specific interventions.

The remainder of this report summarises the discussions held during the annual conference.

Disclaimer. *This report includes the main conclusions from the ECMI Annual Conference held virtually on 30 November and 2 and 7 December 2021. Its content should be attributed solely to the rapporteurs. A detailed overview of the proceedings is available here.*

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The market for the EU's debt: is the EU becoming sovereign?

As a further to the pandemic response, the EU has become a big issuer in international capital markets. With the SURE programme, the Recovery and Resilience Facility, the ESM and EIB loans, total issuance will exceed EUR 1.4 trillion. The EU thus has a safe asset, with an important part of these bonds being green.

This session analysed how the EU's safe asset market is working and discussed burning questions such as: what about issuance calendar, standards and the applicable law? Are collective action clauses applicable? What about secondary market activity? And what about the distribution and yield curve?

Speakers

- **Kalin Anev Janse**, Chief Financial Officer and Management Board Member, European Stability Mechanism
- **Niall Bohan**, Director of Asset, Debt and Financial Risk Managements, DG BUDG, European Commission
- **Isabelle Vic-Philippe**, Head of Euro Aggregate, Amundi Asset Management
- **Annemarie Coldeweijer**, Head of SSA Markets and Covered bonds, Global Capital Markets, Blackrock

Moderator:

- **Jennifer Laidlaw**, Senior ESG Writer, S&P Global

Summary

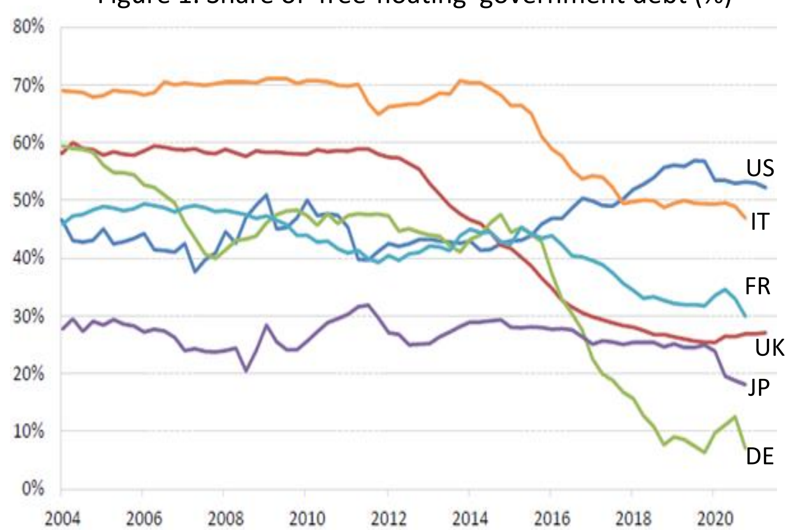
Having an EU-blended bond like the one offered under the Next Generation EU (NGEU) programme, represents a unique opportunity to lay the foundations for a truly European safe asset. NGEU borrowing will be used up for loans and finance grants, which is completely new. In addition, the aim is to set the EU on the path as the benchmark green bond issuer and to build a liquid curve from 5 to 30 years.

The European Commission is acting like a *de facto* sovereign issuer. The Commission issues debt though for very delineate policies, and in contrast to a sovereign issuer it does not have rolling financing needs. Having said that, there are two important consequences. First, issuance is very closely linked to what the expenditure needs of the European economy are – both in terms of timelines and amount. Second, debt issuance is limited and it will cease in 2026 for the NGEU. However, refinancing could go beyond 2026 for another ten years, up until 2036.

The Commission has gone to the market to fund identifiable social and economic recovery needs, by also adding a sustainability twist to the process (about 30 % of the EU debt is green). Thus, the issuance of EU debt can take place without crowding out Member States, given that the Commission is funding complementary needs at a different level of government.

The EU's debt is now on a par with that of sovereigns, a big shift compared to where Europe was pre-pandemic. Moreover, from the market side there is a huge appetite for highly liquid and highly rated EU debt. Factors such as flight to quality, the search for safety, the scarcity of safe assets, and collateral needs contribute to this demand. For example, with regards to the scarcity of safe assets, there is only around 10 % of German debt that is actually available to all investors (Figure 1).

Figure 1. Share of 'free-floating' government debt (%)



Source: Deutsche Bank and Haver Analytics.

Borrowing from the markets can be a useful component for the EU budget, particularly in dealing with longer-term funding needs. The EU budget remains small as a percentage of GDP (around 1 % of the EU's total GDP). However, by augmenting it with an additional amount of borrowing of up to 0.6 % GDP per year, the borrowing under NGEU can have a real impact on the EU as a whole.

Finally, the Commission's issuance programme also has spin-off benefits in terms of the enhanced international capital market recognition of the euro. The EU can offer international investors an instrument that they can trust and trade in and out of for diversification purposes. Moreover, the EU's debt issuance is not going to break the sovereign doom loop in and of itself, but is an alternative tool to sovereign debt issuance. Overall, the diversification away from domestic sovereigns strengthens the bank balances.

Private equity, CMU and the recovery

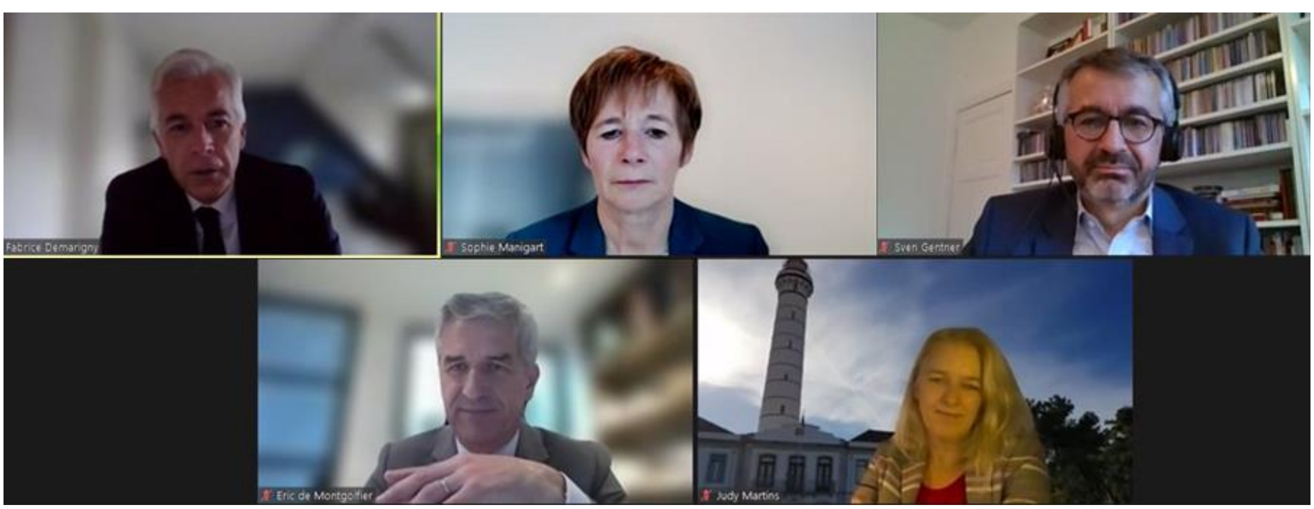
Governments, central banks and others have pumped billions of euros into small businesses in an effort to keep them alive in response to Covid-19. To restart company growth, make vital investments, restructure debt and spur the growth of young and innovative companies there is need for more equity finance. This is where private equity could potentially play a vital role. Moreover, private equity funds had record amounts of capital for future investments at the end of 2020 (about EUR 300 billion in Europe and above EUR 1.8 trillion globally).

This session focused on whether private equity should have a bigger role in the recovery of the EU? What are the regulatory and operational challenges that private equity is facing today? Are private-public co-investments working?

Speakers

- **Eric de Montgolfier**, CEO, Invest Europe
- **Sophie Manigart**, Professor of Corporate Finance and Faculty Dean, Vlerick Business School
- **Sven Gentner,** Head of Unit Asset management, DG FISMA
- **Judy Martins,** General Counsel and Compliance Officer, Waterland Private Equity Investments

Moderated by **Fabrice Demarigny,** Global Head of Financial Advisory Services and Capital Markets Activities, Mazars and Chairman of ECMI



Summary

The private equity (PE) and venture capital (VC) industries represent a bridge between companies and end-investors. In 2020, PE and VC funds invested over EUR 88 billion in the European economy supporting around 7 000 SMEs. At the same time, investing companies backed by PE and VC funds represented more than 10 million jobs in the EU, with a job creation rate five to six times the EU average. They target best in class companies, all segments in terms of size, sectors and strategies. As for the number of deals, there are strong preferences for the information and communication technologies (ICT), healthcare, consumer goods, and transportation sectors. The twin transition – green and digital – is expected to provide additional financing opportunities.

The EU PE and VC ecosystem is not completely self-sufficient. Unlike the US and Asia, Europe is a net importer of capital. This is not necessarily a bad thing as external capital also allows for the exploration of those international markets, thus making it easier for European companies to have a stronger footing there.

The results of an academic meta-analysis covering 480 000 buyouts between 1980 and 2020 showed a positive impact on growth and employment in companies backed by PE/VC. However, these positive effects are driven by Anglo-Saxon countries, with the evidence for continental Europe being statistically insignificant. In practice, there are strategies supporting: i) organic growth, ii) buy and build/acquisition, iii) the provision of knowledge and expertise to companies that want to expand, iv) the engagement process with other financing parties, and v) the delivery of meaningful change management and strategic direction.

There are also further developments in terms of cross-border integration, with growth in scale and scope needed to create critical mass. In terms of the Capital Markets Union (CMU) and the fitness of rules, integrated information will be made more accessible through the European Single Access Point (ESAP), burdens will be reduced (lighter rules and lower access barriers to retail investors) wherever possible in the European long-term investment funds (ELTIF), while harmonisation of the Alternative Investment Fund Managers Directive (AIMFD) frameworks around loan-originating funds (debt funds) will facilitate more lending.

Additionally, the recalibration of prudential rules for banks (Capital Requirements Regulation - CRR) and insurance companies (Solvency 2) will ensure that institutional investors give their long-term equity exposures the risk charge they deserve. Finally, the Sustainable Finance Disclosure Regulation (SFRD) poses significant challenges in terms of limiting the burden on reporting and increasing overall effectiveness in driving positive changes.

Crypto-assets: investors beware

The appeal of crypto-assets is increasing at a rapid pace, but the investor protection regime is confusing or still under construction. The location, valuation and taxation of crypto-assets are very shallow. Crypto-asset trading platforms are emerging, but the rules applicable are unclear, and market abuse is a problem. As the first international institution to do so, the European Commission has proposed to regulate crypto-assets under a tailor-made regime, the Markets in Crypto-Assets (MiCA) regulation, with a separate definition of digital assets. But this contrasts with the US or Hong-Kong, which both consider crypto assets as securities.

This session analysed the interplay of MiCA with other existing and proposed rules (e.g., digital identity and privacy, e-commerce and digital markets and services, anti-money laundering, crowdfunding) and how European supervisors will deal with these new tasks.

Speakers:

- **Nobuyasu Sugimoto**, Senior Financial Expert, IMF
- **Julapa Jagtiani**, Senior Special Advisor , Philadelphia Fed
- **Almudena de la Mata**, Blockchain Intelligence and IE Business School, Madrid
- **Teana Baker-Taylor**, Chief Policy Officer, Chamber of Digital Commerce

Moderator:

- **Karel Lannoo**, General Manager of ECMI and CEO of CEPS

Summary

The market value of crypto assets has grown enormously to almost USD 3 trillion in 2021, of which bitcoin still forms the bulk (Figure 2). Most of the crypto exchange trading takes place in offshore financial centres, which raises questions about governance, transparency, and money laundering (Figure 3). The adoption of crypto is highest in emerging markets such as Nigeria, the Philippines and Vietnam, at the same time indicating the link between an affordable payments transmission system and the need for central bank digital currencies.

Figure 2. Market capitalisation of crypto assets in (USD billion)

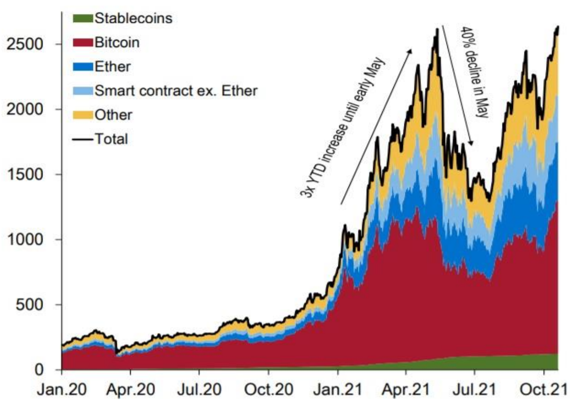
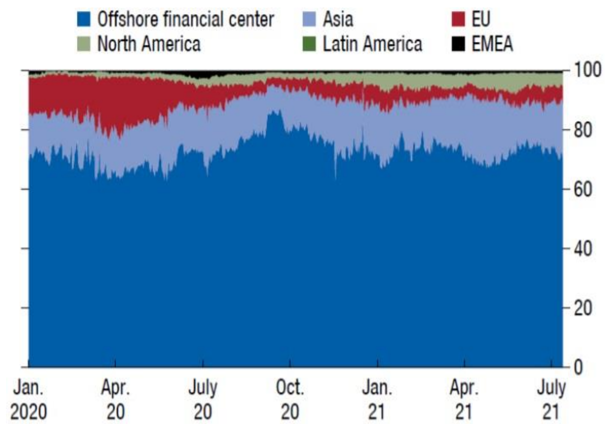


Figure 3. Trading activity of exchanges by registration (%)



Source: IMF (2021), 'Global Financial Stability Report', International Monetary Fund, October.

The challenge for regulators however is the international and fast- moving nature of cryptos and their diversity. In addition, it's important to remain open to innovation and be able to effectively adapt.

Decentralised Finance (DeFi) is a set of distributed ledger technology (DLT)-based financial services and applications which has been growing rapidly. The European Commission has proposed a pilot project for DeFi as a regulatory sandbox, but its governance (centralised vs. decentralised) could raise questions. Regulators need to be comprehensive, avoid overlaps and follow a risk-based approach.

With regards to financial inclusion, in a world with 1.7 billion people without a bank account, payment systems need to become faster, cheaper and safer, which crypto might change. The growth of cryptos over the last two years, stimulated by the Covid-19 pandemic, demonstrates the need for this demand. Consequently, this has attracted interest from investors, mostly hedge funds, as an asset for diversification or a tool for liquidity management. These investors have also demanded custody and exchange services for crypto assets.

US regulators, which have so far been most confronted with crypto assets, have followed a variety of regulatory approaches. If considered as a security, the Securities and Exchange Commission (SEC) is responsible, while if considered as an investment commodity, then it is subject to the

Commodity Futures Trading Commission (CFTC) regulation. Finally, banking regulators have been overseeing looking after stablecoins. But overall, the division of responsibility has been confusing to say the least up to now.

In the EU, further to the Markets in Crypto-assets (MiCA) draft Regulation, a single regulatory framework will be put in place, covering crypto assets, stablecoins and e-money. This is seen to be more relevant as crypto is difficult to define. But its passage will definitely be an oversight gamechanger for supervisors, which then raises the subsequent question about supervisory skills.

Moving forward, regulators need to control the risks of crypto assets. However, coordination at the international level and harmonised standards are missing. Although securities markets regulation can form the basis to resolving these issues, significant gaps still remain, especially in areas with systemic importance.

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