

EBCI

Vienna Initiative



Report by the Working Group on Capital Markets Union

Endorsed by the Vienna Initiative Full Forum Meeting

12 March 2018, London

Disclaimer

This report summarises the conclusions of the Working Group on CMU, which was established in March 2017 in the context of the Vienna Initiative. The content and conclusions included in the report are, as any Vienna Initiative product, voluntary, public, nonbinding and should not be regarded as reflecting the official position of the participating institutions. They are intended to inform market participants, policy makers and the general public about suggested approaches and best practices. They shall be in no way interpreted as a restriction on future policy options, including regulatory decisions.

Table of Contents

Executive summary	6
1. Introduction	7
1.1 <i>Establishment of the Working Group</i>	7
1.2 <i>Rationale and purpose</i>	8
1.3 <i>Presentation of the structure of the report</i>	8
2. Taking stock of capital markets in CESEE	9
2.1 <i>Introduction</i>	9
2.2 <i>The catch-up potential of financial markets in Central, Eastern and South Eastern Europe</i> .	9
2.2.1 <i>Capital markets versus bank intermediation</i>	9
2.2.2 <i>Capital markets and growth</i>	12
2.3 <i>Demand for funding</i>	13
2.3.1 <i>The financing structure of corporates</i>	13
2.3.2 <i>The importance of SMEs</i>	14
2.3.3 <i>Financial education and consumer protection</i>	15
2.3.4 <i>The structure of the economy and other factors</i>	16
2.4 <i>Supply of funding</i>	17
2.4.1 <i>The importance of markets and institutional investors in the provision of finance</i>	17
2.4.2 <i>The role of private equity</i>	19
2.4.3 <i>Household savings preferences and the availability of financial resources</i>	20
2.4.4 <i>The regulatory environment and the supply of financial resources</i>	21
2.5 <i>Market infrastructures</i>	22
3. Challenges and opportunities for capital market development	26
3.1 <i>Bulgaria</i>	27
3.2 <i>Czech Republic</i>	30
3.3 <i>Estonia</i>	35
3.4 <i>Croatia</i>	37
3.5 <i>Latvia</i>	40
3.6 <i>Lithuania</i>	44
3.7 <i>Hungary</i>	47
3.8 <i>Former Yugoslav Republic of Macedonia</i>	50
3.9 <i>Poland</i>	53
3.10 <i>Romania</i>	58
3.11 <i>Slovakia</i>	61
3.12 <i>Slovenia</i>	64

4. Policy conclusions	67
4.1 <i>Priorities for policy action at the national level</i>	67
1.1.1. National strategy and promotion	67
4.1.2. Business environment.....	67
4.1.3. Public support for companies to access capital market	68
4.1.4. Privatisation.....	69
4.1.5. Institutional investors	69
4.1.6. Financial education.....	69
4.1.7. Supervision.....	69
4.2 <i>Potential for cross-border projects and cooperation</i>	69
4.2.1 Foreign listing and market access.....	70
4.2.2. Central Securities Depositories	70
4.2.3. Central Clearing Counterparties	70
4.2.4 Creating regional markets by harmonisation of regulation	70
4.3 <i>Policy issues at EU level</i>	70
4.3.1. Proportionality and implementation of EU regulation	71
4.3.2. Need for harmonisation at EU level	72
4.3.3. EU financial instruments	72
Annex 1	74
Annex 2	76

List of figures

Figure 1: The underdevelopment of capital markets in Central and Eastern Europe in perspective.....	9
Figure 2: Capital market depth and the banking sector in CEE	10
Figure 3: Bank deleveraging towards Central and East Europe	10
Figure 4: Bank lending conditions in CESEE	11
Figure 5: Capital markets depth in CESEE: resilience to shocks and GDP growth.....	12
Figure 6: Total average capital market depth 2008-2016.....	13
Figure 7: Types of finance in CESEE: actual versus wanted change.....	14
Figure 8: Sectoral distribution of economic activity in CESEE	16
Figure 9: Importance of firm size for turnover and the number of large companies in CESEE	16
Figure 10: Provision of finance through capital markets and institutional investors	17
Figure 11: Structure of investment assets of occupational pension funds (2015)	18
Figure 12: The regulatory environment and capital market development.....	21
Figure 13: The insolvency framework	22

List of tables

Table 1: Breakdown of financial liabilities of non-financial corporations in CESEE	14
Table 2: Confidence in talking about finance.....	15
Table 3: Private capital investment in CESEE	20
Table 5: Stock exchanges in CESEE – EU member states (2015).....	23
Table 6: Stock exchanges in CESEE – non EU countries (2015)	23
Table 7: Other elements of capital market infrastructure - EU member states (2015).....	24
Table 8: Other elements of capital market infrastructure - non EU countries (2015)	24

Executive summary

Capital markets in CESEE lag behind their EU peers in terms of liquidity and depth.

Challenges to their further development are triggered by both capital supply and demand factors. The bulk of companies operating in the CESEE region are small. Similar to SMEs in other EU countries, they have to meet high legal requirements to access capital markets. Consequently, companies in CESEE rely heavily on bank financing and are reluctant to use equity, bonds or risk capital. Yet, economic research suggests that prosperous capital market ecosystems contribute to economic growth by lowering the cost of capital and enhancing access to finance. The Capital Markets Union Action Plan adopted by the European Commission in 2015 emphasises the need to further develop capital markets, especially in countries with high catching-up potential such as those from the CESEE region.

In March 2017, the Vienna Initiative Full Forum decided to set up a Working Group on Capital Markets Union.

The Working Group (WG) included about forty representatives of both public and private institutions from CESEE countries as well as international institutions (i.e. EIB, EBRD and the World Bank Group). The European Commission chaired the works. The objective of the WG was to provide an overview of challenges faced by capital markets in CESEE and to identify measures necessary to enhance local capital markets to be implemented at national, cross-border and European level. To this end, the WG carried out a country survey among its members. The survey results are summarised in individual sections of the WG report, covering twelve countries of the region.

The report of the Working Group lists policy actions that can be taken to support the development of local capital markets. The proposed measures are both of legislative or non-legislative nature. They include new initiatives and relate to initiatives already underway. The following action points are highlighted:

- **National level:** national initiatives are crucial for capital market development. These include development of capital market strategies, modernisation of the business environment, using public financial support for capital markets, e.g. listing of SMEs, privatisation of state-owned companies through the stock exchange, facilitating conditions for institutional investors, enhancing capital market supervision and increasing financial literacy.
- **Regional level:** further measures could be taken to strengthen cross-border cooperation. This includes facilitating foreign listing and market access, promoting cooperation between stock exchanges and the creation of cross-border links between local market infrastructures (CSDs, CCPs) and harmonising legislation at regional level.
- **EU level:** issues revolve around better regulation and a greater use of the available financing instruments. Further work is warranted on the observance of the proportionality principle in EU law (i.e. by review of selected capital market directives), on better implementation of EU law (e.g. by technical support) and further harmonization of legislation at EU level (e.g. in the area of crowdfunding or fintech). The deployment of financial support instruments (e.g. by the European Structural Investment Funds, EIB EBRD or the World Bank Group) will help overcome market failures and increase the funding pool for investments.

1. Introduction

1.1 Establishment of the Working Group

On 6 March 2017, the Vienna Initiative Full Forum decided to set up a Working Group on Capital Markets Union (CMU) upon the proposal from the European Commission. All interested Vienna Initiative members, i.e. representatives of both public and private institutions from Central, Eastern and South-Eastern Europe countries (CESEE), as well as international institutions such as: the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD), the International Monetary Fund (IMF) and the World Bank were invited to take part in this Working Group. The European Commission undertook to coordinate the work, chair the meetings and provide the Secretariat of the Working Group.

Three one-day meetings of the Working Group were held on 4 April, 30 June and 3 October 2017 in Brussels. The following institutions and organisations participated in at least one meeting and provided their contributions to the discussions and to the report produced by the Working Group:

1. Association for Financial Markets in Europe (AFME)
2. Bulgarian Stock Exchange
3. Croatian Financial Services Supervisory Agency
4. Croatian National Bank
5. Czech Capital Market Association
6. Czech National Bank
7. Erste Group Bank AG
8. Eurochambers
9. European Bank for Reconstruction and Development
10. European Commission
11. European Investment Bank
12. Federal Ministry of Finance, Austria
13. Financial Supervisory Authority, Romania
14. Hungarian National Bank
15. International Finance Corporation
16. KBC Group NV
17. Ministry for National Economy, Hungary
18. Ministry of Finance, Czech Republic
19. Ministry of Finance, Latvia
20. Ministry of Finance, Lithuania
21. Ministry of Finance, Poland
22. Ministry of Finance, Slovakia
23. Nasdaq Tallinn, Estonia
24. Oesterreichische Nationalbank, Austria
25. Permanent Representation of Estonia to the EU
26. Permanent Representation of Poland to the EU
27. Permanent Representation of Slovak Republic to the EU
28. Polish Agency for Enterprise Development (PARP)
29. Prague Stock Exchange, Czech Republic
30. Raiffeisen Bank International
31. Raiffeisen Bank Romania
32. Schroders, United Kingdom
33. Securities and Exchange Commission, Former Yugoslav Republic of Macedonia
34. Securities Market Agency, Slovenia
35. Unicredit
36. Warsaw Stock Exchange, Poland
37. World Bank

1.2 Rationale and purpose

The Capital Markets Union is one of the European Commission's priority initiatives in the area of financial services aiming to mobilise capital in Europe and channel it to companies, including small and medium enterprises (SMEs), and infrastructure projects so that they can expand and create jobs. Economic analysis shows that countries from Central, Eastern and South-Eastern Europe, including non-EU Member States lag behind in terms of capital markets development, leading to a reduced choice of options for financing of business start-up and expansion.

The CMU Action Plan¹, adopted by the European Commission in September 2015, emphasises the need to take measures allowing for further development of capital markets in the countries with high catch-up potential, such as those from the CESEE region. The establishment of the Working Group on Capital Markets Union is one of the actions to help in this process. The objective of the Group, as defined by the Terms of Reference (*Annex 1*), is to provide a more coherent picture of capital markets' development and their main features in CESEE countries. This work is to help identify further initiatives necessary to enhance local capital markets that could be implemented at national or European level. It also aims at identifying the conditions required to create more diversified financial markets in the CESEE region, where bank funding would be complemented by strong capital markets, thus giving firms more financing alternatives. Furthermore, it is supposed to examine comparative advantages and obstacles for the development of national capital markets, both within the region and beyond.

The Structural Reform Support Service (SRSS) of the European Commission provides technical support to Member States, including within the area of capital markets development. The SRSS has closely followed the activity of the Working Group and stands ready to assist Member States, upon their request, with country-specific technical support to address recommendations stemming from this report. Many such projects in CESEE countries have been launched since the Working Group was established.

This CMU Working Group built further on the Working Group on Local Currency and Capital Market Development which ran in 2010-2011 in the framework of the Vienna Initiative. Its report was endorsed by the Full Forum in Brussels in March 2011.²

1.3 Presentation of the structure of the report

The report continues with a stock-taking chapter, which contains economic analysis of the level of capital market development in the region. This chapter focuses on the factors contributing to the high catching-up potential of the CESEE economies, such as the lower level of development of most capital market segments relative to the EU average. It also reviews the corporate funding structures in the region to analyse the demand for capital as well as the main categories of investors – to give a picture of the supply side.

The third chapter of the report presents the challenges and obstacles for capital market development in several CESEE countries and identifies the proposals to address them. It is composed of individual sections covering the countries in the region participating in the Working Group. The content of the country-specific sections is largely based on the participants' replies to the questionnaire developed by the Working Group (*Annex 2*) and on the discussions held by the Working Group.

Finally, the last chapter summarises conclusions on relevant policies that may be pursued to stimulate capital market catching-up in the participating countries and in the CESEE region as a whole. It also points at some policy issues at the EU level, in particular as regards the ways to foster implementation of the Capital Markets Union.

¹ http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf

² <http://www.ebrd.com/news/2011/report-by-the-public-private-sector-working-group-on-local-currency-and-capital-market-development.html>

2. Taking stock of capital markets in CESEE

2.1 Introduction

This chapter provides an overview on the state of play of capital markets development in emerging Europe, with particular focus on the countries in Central, Eastern and South Eastern Europe (CESEE) within the EU³. These countries are among those which have the potential to reap significant benefits from the Capital Markets Union (CMU) as their capital markets are still structurally less developed than in other EU Member States. In several of these countries with a still relatively low per capita income and a less developed financial sector, there is a strong need for investment, in particular in infrastructure. Although the privatisation of state-owned enterprises started back in the early 1990s, it has not been completed yet. Capital inflows and foreign direct investment are necessary to continue structural reforms, support productivity improvements and the growth in per capita income. To improve the growth potential of these economies, further investments in education and innovation as well as regulatory and institutional reforms appear as warranted. To support this process better developed capital markets are essential to finance investments from both domestic and foreign sources.

The chapter starts with putting the catch-up potential of Central, Eastern and South Eastern Europe into perspective. The subsequent sections 2.3 and 2.4 describe, respectively, the demand for funding and the main sources of finance. The chapter concludes with a section on market infrastructures.

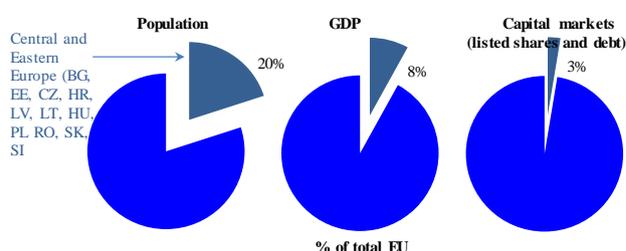
2.2 The catch-up potential of financial markets in Central, Eastern and South Eastern Europe

The case is made that there is a catch-up potential of capital markets in the Central, Eastern and South Eastern Europe and that this is beneficial. Financial intermediation is very much based on banks, which are furthermore foreign-owned with its advantages, but also vulnerabilities. Thus, a more diversified financing structure appears beneficial in terms of economic growth.

2.2.1 Capital markets versus bank intermediation

The countries in Central, Eastern- and Southern Eastern Europe have a high growth potential and better capital markets may contribute to that. These countries account for 20% of the EU-28 in terms of population, 8% in terms of GDP and only 3% in terms of capital market (Figure 1). As of end-2015, the debt market capitalisation in the EU11⁴ countries stood at 52% of GDP, compared to 159% of GDP in the EU-28 and stock market capitalisation accounted for 18% of GDP as compared to 66% of GDP in the EU-28. More developed capital markets can support these economies with more diversified sources to finance growth and development.

Figure 1: The underdevelopment of capital markets in Central and Eastern Europe in perspective



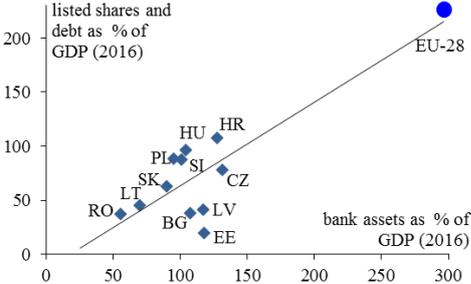
Source: Eurostat, ECB

³ The EU Member States referred to in this paper as EU 11 are Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Romania, Lithuania, Poland, Slovakia and Slovenia.

⁴ Including bills, bonds, certificates of deposit, commercial paper, debentures.

Financial intermediation in the countries of the CESEE region has remained largely bank based. While still below the EU-28 average (Figure 2), the banking sector is more important than the capital market for the CEE countries. The same is also true for other EU Member States, but in the CEE countries the discrepancy appears bigger with the banking sector as a share of GDP being close to twice larger than the market capitalisation of listed shares and bonds compared to about 1.3 for the EU as a whole (Figure 2). Market sources of financing could help unlock the growth potential of these emerging economies and this can go hand in hand with a further development of the banking sector.

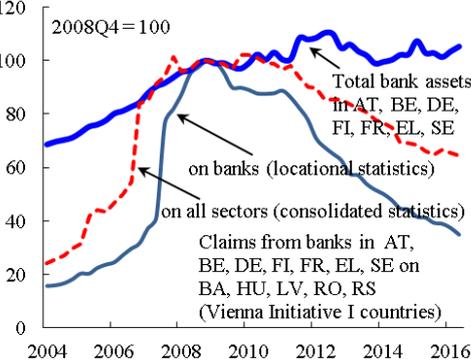
Figure 2: Capital market depth and the banking sector in CEE



Source: ECB

Banking sectors in CESEE are predominantly foreign owned. The average foreign ownership in the banking sector reaches, for example, over 80% in the Czech Republic, Romania or Slovakia. The main foreign banks operating in the region are Raiffeisen Bank International (in 14 countries), Erste Bank Group (in 6), Societe Generale (in 12), OTP (in 9), Intesa SanPaolo (in 9), UniCredit (in 10), KBC (in 4), Sberbank (in 11) and VTB (in 8 countries).⁵ Whereas foreign ownership in the banking sectors in CESEE has brought along several advantages, it makes the host countries vulnerable to decisions taken at headquarters located abroad for which their exposure to the region is usually relatively small.

Figure 3: Bank deleveraging towards Central and East Europe



Source: ECB, BIS

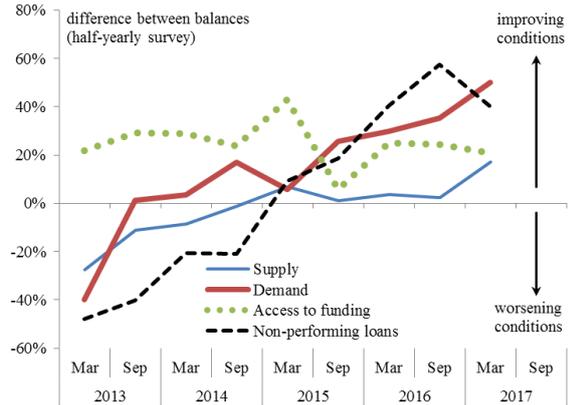
EU parent banks have deleveraged as a response to the euro area debt crisis and global financial crisis. The deleveraging was stronger towards the region compared to the home market (Figure 3). However, the efforts to orderly manage the exposure reduction to the subsidiaries under the Vienna Initiative provided breathing space to the subsidiaries to attract local savings, replace partially the parent funding and contain the overall the deleveraging. At group level, deleveraging expectations stabilised at 2015 levels. Nevertheless, around a third of bank groups continue to reduce their aggregate exposure to the region. The regulatory environment, bank’s capital constraints and stocks of impaired assets are the main factors adversely affecting the supply of bank credit according to the EIB Bank Lending Survey. Increases in capital adequacy have been mainly achieved via the sale of assets, including by closing down and selling branches. Banks are strategically discriminating among the

⁵ [Raiffeisen Research](#)

countries where they operate. Especially in Albania, Croatia, Hungary, Slovenia and Ukraine the banks' perception of market potential has deteriorated. In Bosnia-Herzegovina, Serbia and Slovakia market potential was also assessed as relatively low. At the same time, a significant number of bank groups intend to expand certain operations in the long term⁶.

Recent surveys point towards an increase in credit demand in the region, whereas credit supply has remained stagnant. According to the CESEE Bank Lending Survey of the EIB, the subsidiaries of the euro area parent banks operating in the region and the local banks have continued to report an increase in credit demand, whereas supply conditions were almost unchanged between the third quarter of 2016 and first quarter of 2017 (Figure 4). These demand and supply side developments have generated a perceived increasing demand-supply gap. Supply conditions have remained basically neutral. Across the client spectrum, supply conditions (credit standards) eased partially in the corporate segment, in particular for lending to SMEs. Meanwhile, credit standards tightened on mortgage lending and did not change for consumer credit. Supply conditions eased slightly for short-term loans, primarily for those denominated in local currency. Demand is expected to continue to increase in the coming months, whereas supply conditions are expected to ease only slightly. In a nutshell, subsidiaries and local banks operating in CESEE have reported an increase in credit demand since the last seven semesters, while supply conditions have remained basically unchanged. These developments also underscore the importance of further diversifying the sources of financing available to both firms and households.

Figure 4: Bank lending conditions in CESEE



Source: EIB CESEE Bank Lending Survey

The persisting credit demand-supply gap may contribute to the development of the corporate bond market. Looking ahead, the rather stagnant credit supply could contribute to increasing interest among firms to use the capital market as an alternative source of financing. However, these prospects are also subject to the currently rather abundant liquidity in the corporate sector (particularly among large corporates) and the cost-benefit-balance of bond issuance for smaller firms.

Box 1: Vienna Initiative Working Group on IFI financial products supporting investment

Availability of suitable financial instruments is crucial both for capital market development and for supporting investment in the economy. Institutional investors may be attracted by well-designed products, offering the right mix of risk and profit. Large projects, such as investment in digital infrastructure, R&D, energy efficiency, domestic capital market infrastructure, education and healthcare infrastructure, may thus benefit from a larger pool of financing.

There are still significant gaps in the stock of capital in the CESEE that could be filled by switching to more reliance on internal savings and a more efficient use of available domestic funding sources. The EU structural

⁶ [EIB bank lending survey](#)

and cohesion funds help by investing in job creation, sustainable growth and the green economy in the Member States from the region. International Financial Institutions (IFIs) also provide support for investments by way of loans, guarantees, equity and other risk-bearing mechanisms, possibly combined with technical support and grant based funding within the same operation.

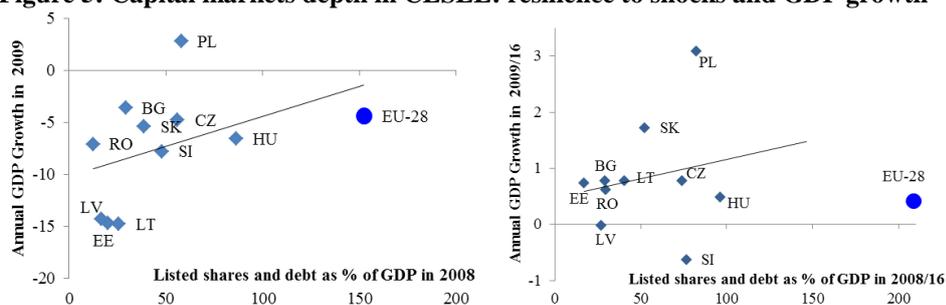
The CESEE region has been an important beneficiary of various loans and other financial products provided by IFIs and the EU. It is of crucial importance to collect the existing experience and accumulated knowledge in the region on the use of these financial products, and channel this knowledge into the development of the next generation of financial products provided by IFIs.

In this context, in April 2017 the Steering Committee of the Vienna Initiative accepted the proposal of the European Investment Bank to establish a Working Group on IFI financial products supporting investment. The key objective of the Working Group will be to:

- Identify markets gaps and policy priority areas for (private and public) investment that are best served by financial products offered by IFIs, building as much as possible on existing research by IFIs (e.g. the EIBIS survey); evaluate the experience and lessons learned on such products, including their efficiency in terms of the best allocation of EU money, e.g. through the highest outreach or incentives for private uptake;
- Support the development of appropriate combinations of instruments to meet investment needs of the CESEE region, with an emphasis on sustainability through including local funding and investment as part of, or in parallel to, the IFI funding instruments;
- Assess the needs and characteristics of the local investor base so as to be able to structure IFI instruments that will encourage their participation in the investment needs of the CESEE region;
- Assess how to strengthen the cooperation amongst IFIs, as well as between IFIs and national entities on the harmonisation and streamlining of the supply of financial products supporting investment and a balanced allocation of the management of the financial instruments between commercial banks and promotional banks; and
- Contribute to the debate on shaping the next generation of IFI products with a focus on sustainability and complementarity in the development of local capital markets.

The Working Group will produce a report presenting the most important points of the discussion, highlighting the experiences and proposing solutions for the development of financial products (loans, guarantees, equity instruments etc.). Based on this analysis the IFIs may consider introduction of the proposed instruments. Given the different legislative context and state aid rules, the analysis and proposals will be sub-clustered in EU Member States in CESEE and non-EU Member States in CESEE.

Figure 5: Capital markets depth in CESEE: resilience to shocks and GDP growth



Source: ECB

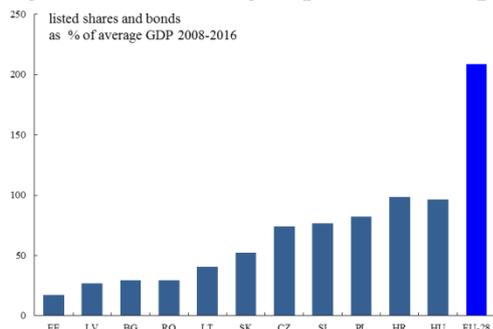
2.2.2 Capital markets and growth

Capital markets have the potential to improve resilience to shocks and foster growth. While economic resistance is a complex issue, CESEE countries with deeper capital markets at the onset of the crisis appear to be less hit in terms of GDP contraction than some of their peers with less developed capital markets (Figure 5). Certainly, the depth of the crisis in e.g. the Baltic States was not due exclusively to the lack of capital market development in 2009; it was just one among other elements. Since then, the region has picked up with economic growth at 3% on average, down from about 7% before the crisis. Countries with the deeper capital markets in the region seem to post the stronger growth rates, but generalisations are difficult as there are many drivers of economic

development (see Box 1 how financial instruments offered by the international financial institutions can contribute to investment and capital market development).

Capital markets may play a pivotal role in contributing to restore rapid and sustainable economic growth. Capital market depth (proxied by listed shares and bonds) is much below the EU-28 average and varies largely between the EU11 countries (Figure 6). The Baltic countries, Romania and Bulgaria are among the countries with the lowest total stock market capitalisation. Catching up with the deeper capital markets of peers could unleash "more than EUR 200 billion in long-term capital, deliver more than EUR 40 billion a year in extra funding for companies" in the region of CESEE.⁷

Figure 6: Total average capital market depth 2008-2016



Source: Eurostat

2.3 Demand for funding

Looking at the financing structure, it appears that firms in CESEE rely more on banks compared to the rest of the EU. The extent to which this can be changed depends on the drivers of the preference for bank credit. Three aspects are examined: the role of SMEs (bank-oriented because of their small size), financial literacy (a general issue in CESEE countries) and the specialisation of the economy (industrial sectors are more capital market dependent).

2.3.1 The financing structure of corporates

The use of capital markets by non-financial corporations (NFC) is below the EU average and varies largely between CESEE countries. Like in all of EU, own resources represent the largest share in the financing of enterprises in each CESEE country. In Croatia (14% of total financial liabilities) and Poland (12%) listed shares are relatively most used for financing corporations (Table 1), compared to their peer countries in region, but still well below the EU average (21%). Debt securities have the highest importance for firms in the Czech Republic (5% of total financial liabilities) and Poland (4%), while they are least important in Romania and two Baltic countries (Lithuania and Latvia).

By contrast, loans play a very important role in the external financing of non-financial corporations across CESEE. Financing through loans is the most important in Croatia with 43% of total financial liabilities, followed by Bulgaria (39%), Latvia and Slovenia (38%). Furthermore, in several CESEE countries, the share of trade credit and advances in the total liabilities of non-financial corporations is substantial and surpasses the EU-28 average of 6% (Table 1). It should be noted that these liabilities are financed by both domestic and foreign creditors in each instrument category.

Also the volume of Initial Public Offerings (IPOs) in the CESEE region is low and has declined after the outbreak of the financial crisis in 2008. According to the latest data published by the

⁷ [AFME and New Financial 2016](#)

Federation of European Securities Exchanges (FESE), the IPOs by value in the CESEE accounted for 3.3% of the total IPOs in EU-28 in 2016. In terms of IPO numbers, out of the 139 new listings registered by end-2016 in EU-28, 17 (12.2% of the total) took place in the CESEE countries, testifying to the region's high growth potential. Similar to previous years, the bulk of new IPOs, namely 13, took place at the Warsaw Stock Exchange, with the remainder four in Bulgaria, Czech Republic, Estonia and Romania. The lack of IPOs is possibly also linked to the low volumes of foreign direct investment (FDI) and cross-border mergers and acquisitions which remain still below pre-crisis levels.

Table 1: Breakdown of financial liabilities of non-financial corporations in CESEE

2015 % total financial liabilities	Own resources	of which			Debt securities	Loans	Other accounts receivable / payable
		Listed shares	Unlisted shares	Other equity			
EU-28	54.0	20.9	-	-	5.7	28.6	6.4
Bulgaria	49.9	1.2	23.7	25.0	1.3	38.9	9.8
Czech Republic	52.3	7.7	27.2	17.4	5.4	24.9	16.5
Estonia	60.9	2.2	47.3	11.3	3.0	28.4	7.5
Croatia	45.6	13.8	10.0	21.9	2.9	43.4	8.0
Latvia	41.6	2.1	-	-	0.5	38.3	19.6
Lithuania	58.6	3.0	52.9	2.7	0.2	25.6	15.5
Hungary	59.5	4.8	17.9	36.8	0.7	31.7	7.5
Poland	50.5	12.4	12.1	26.1	3.9	30.4	14.8
Romania	38.9	6.2	19.5	13.2	0.1	36.0	25.0
Slovenia	46.0	7.8	11.8	26.5	1.9	38.3	13.6
Slovakia	47.2	2.2	42.9	2.2	3.0	27.7	22.1

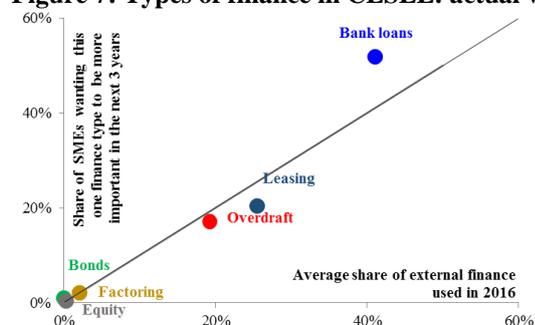
Source: Eurostat

A large part of NFC debt is held by foreign creditors. To a large extent it takes the form of intracompany lending, which forms part of the total inward FDI stock in these countries and is split in Table 1 into the instrument categories “debt securities”, “loans” and “other accounts payable”. The equity part of the inward FDI stock is shown mainly under unlisted shares and other equity. This situation shows the close real and financial integration of NFC sectors in CESEE with those in other EU Member States. Often, the issuance of bonds (as well as taking out loans) at the group level (with headquarters located in Western Europe in many cases) is preferred for cost-saving and certainty reasons.

2.3.2 The importance of SMEs

SMEs are important drivers of economic growth in Central and Eastern Europe warranting paying special attention to their financing demands. In the region almost all firms are SMEs defined by the EU as companies with less than 250 employees combined with turnover smaller than EUR 50 million or a balance of not more than EUR 43 million. They account for around 70% of employment and produce about 60% of value added.

Figure 7: Types of finance in CESEE: actual versus wanted change



Source: EIB, Investment Survey 2017

While not the major concern, access to finance is an issue for many SMEs. According to the SAFE 2016 survey⁸, finding customers and the capacity to attract qualified staff are the concerns most often mentioned. Notwithstanding progress in recent years, access to finance is mentioned as the major problem for some 6% to 15% of SMEs operating in CESEE countries, compared to an EU-28 average of 9%. Croatia, Former Yugoslav Republic of Macedonia (further in this chapter referred to as FYROM), Lithuania are among the countries where SMEs report the most difficulties, whereas in Estonia and Slovakia least issues are encountered according to the survey.

Loans are by far the preferred funding means of SMEs. According to the SAFE survey, the issuing of debt securities is considered irrelevant by the vast majority of SMEs in CESEE (compared to about 90% in the EU-28). Equity issuance is reported as unimportant by roughly 80% of SMEs. Similarly, the EIB Group Investment Survey of 4881 firms in CESEE EU Member States showed that firms in the region want more of the type of external finance that they are already using for investment activities, most predominantly bank loans (Figure 7). In order for the firms to use more of other external sources of finance, for example private debt⁹ from non-bank lenders, more pro-active measures are needed to change economic conditions and incentives conducive to tapping capital market financing.

2.3.3 Financial education and consumer protection

Besides regulatory issues (see section on supply of capital) part of demand for funding can be explained in terms of financial literacy of companies. According to the SAFE survey, talking to equity and venture capital providers is clearly less easy for European SMEs than applying to the bank for a loan. This is an issue in the EU as a whole (Table 2), but the lack of confidence of small companies' managers appears more pronounced in Central and East Europe.

Table 2: Confidence in talking about finance

yes, %	With banker	With equity and venture capital investor
EU-28	67	22
Bulgaria	75	22
Czech Republic	69	9
Estonia	57	21
Croatia	62	16
Latvia	43	12
Lithuania	44	20
Hungary	59	18
Poland	67	25
Romania	51	14
Slovenia	62	12
Slovakia	69	23

Source: SAFE Survey 2016

Consumer protection for financial services users is another important factor for development of capital markets. The relationship between sellers of securities, investment advice or collective investments and their clients is one of the core pillars for the fair, sound and efficient securities markets. According to good practices identified by the World Bank¹⁰, consumer protection in the securities sector requires a robust legal framework and competent government institutions implementing it. Such framework should contain detailed provisions against false advertising,

⁸ Survey on the access to finance of enterprises (SAFE), http://ec.europa.eu/growth/access-to-finance/data-surveys_en

⁹ Private debt comprises mezzanine and other forms of debt financing that comes mainly from institutional investors such as funds and insurance companies. In contrast to publicly listed corporate bonds, private debt instruments are generally illiquid and not regularly traded on organised markets. They originated in the UK and the USA, where they are an established form of funding for fast-growing, medium-sized companies.

¹⁰ Based on the World Bank's evaluation of financial consumer protection framework in more than 30 countries:

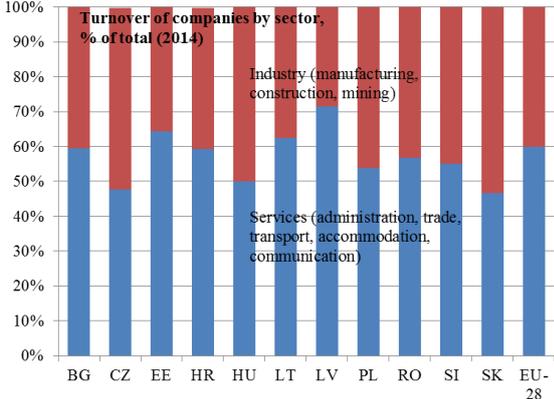
<http://responsiblefinance.worldbank.org>.

misrepresentations or mis-selling as well as out-of-court dispute resolution schemes. Transparency of contracts, high business ethics and protection of privacy are also crucial.

2.3.4 The structure of the economy and other factors

The structure of the economy in terms of sectorial specialisation and firm size is also one of determinants for the choice of the corporate financing source. Industry plays a bigger role (Figure 8) in countries like Slovakia (53%), the Czech Republic (52%), Hungary (50%) and Poland (46%). In particular, manufacturing is investment-intensive and a large such a sector may imply a higher demand for capital.

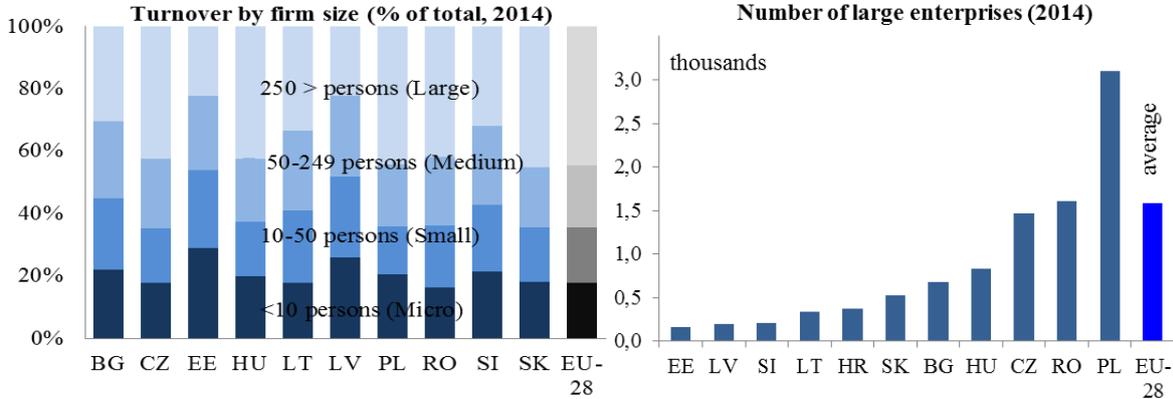
Figure 8: Sectoral distribution of economic activity in CESEE



Source: Eurostat

Similarly, large firms have an easier access to capital markets as size matters to cope with its information and cost requirements as well as implications for ownership. In CESEE, SMEs are relatively more important in generating output and there are fewer large companies than in the EU as a whole (Figure 9). SMEs defined as employing less than 250 people account for between 78% (Estonia, Latvia) and 55% (Slovakia) of production compared to 56% in the EU as a whole. In particular, micro and small firms are important in the region for the production process, while large firms are typically less numerous. Only Poland with more than 3000 large firms is significantly above the EU average. SMEs are often owned by a single person or otherwise by family members from which follows different financial preferences than large firms concerning shareholder rights on profits and readiness to indebt the firm.

Figure 9: Importance of firm size for turnover and the number of large companies in CESEE



Source: Eurostat

Regulatory changes will also shape the demand for funding in the coming years. For example, regulatory MREL-requirements according to which banks have to hold a certain minimum of ‘bail-

inable' liabilities could provide boost to bank bond markets. Particularly domestically owned banks will have to increase their issuance volume. In addition, there is some (latent) interest of subsidiaries of foreign parent banks to issue bonds within the framework of a resolution strategy following an MPE (Multiple Point of Entry) approach. The development of the corporate and bank bond market poses a risk of crowding-out. Unless demand of international portfolio investors for bonds issued in CESEE strengthens, an increased bank bond issuance induced by regulatory measures such as MREL might counteract efforts to develop and deepen the corporate bond market.

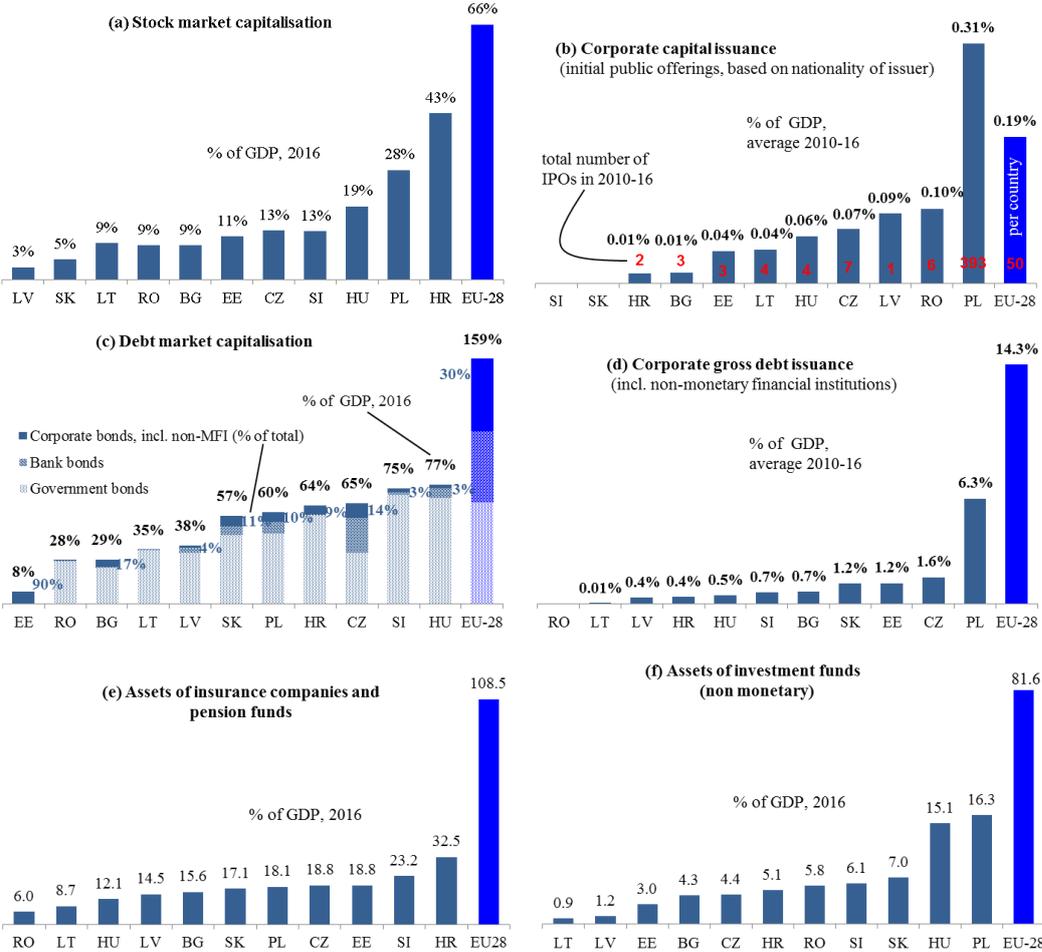
2.4 Supply of funding

As for the determinants of the demand for funding, an understanding of the financing sources is needed if the intermediation of savings via capital markets is to be fostered. Four aspects are highlighted: (i) the underdevelopment of institutional investors; (ii) the role of private equity; (iii) the household preference for bank deposits and (iv) the regulatory environment.

2.4.1 The importance of markets and institutional investors in the provision of finance

Financing through capital market is less developed in the region compared to the EU average. Equity markets in the region were strongly hit at the onset of the financial crisis and have not managed so far to recover to pre-crisis levels. They also lag behind the EU as a whole (Figure 10.a). In absolute terms, Poland has remained by far the country with the largest stock markets as compared to its CESEE peers (with a market capitalisation of EUR 119.6 billion), followed by the Czech Republic and Hungary. In terms of market capitalisation as share of GDP, Croatia (43%) and Poland (28%) have the deepest equity markets, whereas Latvia and Slovakia (5% or less) lag significantly behind.

Figure 10: Provision of finance through capital markets and institutional investors



Source: ECB, Association for Financial Markets in Europe

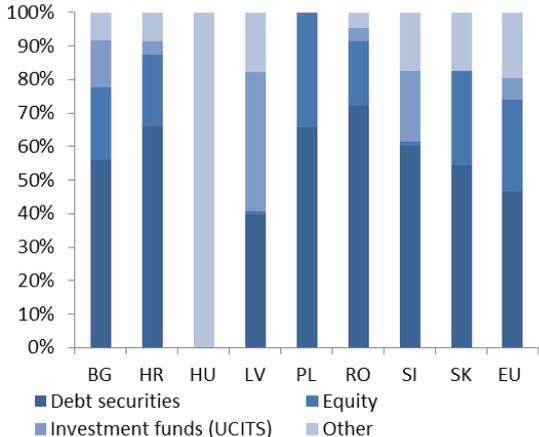
Raising capital through initial public offerings is also behind the EU average except in Poland, reflecting the buoyant economic activity in the country in the last decade (Figure 10.b). Actual issuance on the local market may be overstated as the data are based on the nationality of the issuer, to the extent that large companies in smaller markets may seek to raise finance in larger exchanges like the London Stock Exchange. While the domestic bias in equity issuance (language barriers, research coverage, documentation, etc.) leads companies to issue on their national exchange, the lack of liquidity and deep pools of capital make may guide them abroad.

Whereas the development of equity markets has remained subdued since the onset of the financial crisis, debt markets have expanded. In Poland, the Czech Republic and Romania the volume of bonds has grown significantly in recent years. However, this increase has been mainly driven by the increase in government securities (Figure 10.c). Linked to its size, Poland has the highest amount outstanding of securities other than shares in absolute terms compared to CESEE peers (EUR 211.2 billion) and Estonia the lowest (EUR 1.6 billion). In relative terms, Hungary (77%) and Slovenia (75%) have the deepest long term debt markets (Figure 10.c), albeit still way below the EU average (159%). Issuing debt by firms as a means to attract finance remains underdeveloped in the region (Figure 10.d). The highest annual gross provision of funding during 2010-16 is 6.3% of GDP in Poland, still well under the 14.3% of GDP observed in the EU on average. In consequence, the outstanding stock of corporate bonds as a share of the total in most countries is much behind the 30% observed in the EU on average.

Insurance undertakings, pension funds and investment funds play a key role for capital market development as large institutional investors. They are intermediating between household savings and investment on capital markets. Similar to equity and debt markets, insurance companies, pension and investment funds play a lesser role in the region compared to the EU as a whole and there is a lot of country variation. Assets of insurance undertakings and pensions as share of GDP (Figure 10.e) stood at roughly 33% in Croatia compared to 6% in Romania (108% in the EU). Investment funds (Figure 10.f) have been more developed in Poland (with assets amounting to 16% of GDP) and Hungary (15%), but less so in the Baltic countries (less than 3%) compared to the EU (82%).

The investment portfolio of institutional investors in CESEE seems to be relatively oriented towards debt securities. With respect to occupational pension funds, they are relatively small in the region, with the exception of Romania, Slovenia and Slovakia. The share of equity varies from negligible in Hungary, Latvia and Slovenia to 34% in Poland, compared to 29% in the EU on average (Figure 11). Debt securities, mostly government debt, represent more than 50% of the asset held by the occupational pension funds in a majority of the countries compared to the EU average of 49%. Investments in UCITS play an important role in Latvia, Slovenia and Bulgaria.

Figure 11: Structure of investment assets of occupational pension funds (2015)



Source: EIOPA

Similar to the financial sectors of the EU countries in CESEE, the financial sectors of the non-EU countries are significantly bank based. Whereas the degree of financial sector development varies across these countries, the high reliance on banking sector intermediation is a common feature. For instance, banking sector assets accounted for roughly 91.2% and 90.4% of the total financial sector assets in Serbia (2016) and Albania (2015). FYROM had the lowest share of banking sector assets but it was still high compared to the EU average (some 85.2% in 2016). In recent years, non-bank financial intermediaries (mainly insurance companies and pension funds) have expanded their presence in the non-EU countries in the region, but their contribution to the total assets of the financial sectors of these countries has remained limited (between 8.8% in Serbia and 14.8% in FYROM in 2016).

Notwithstanding efforts in recent years to develop capital markets, these markets have remained underdeveloped in most of the non-EU countries in the region. Local stock markets have contracted in most of the non-EU countries since the financial crisis and have struggled to recover. They are confronted with various weaknesses including low liquidity. The size of the stock market as compared to GDP has also declined in the non-EU countries in recent years. The local debt markets are dominated by government bond issuances, which in turn are held mainly by the banks operating in these countries. Except in Albania and Bosnia and Herzegovina, the size of the local bond markets compared to GDP has declined in the non-EU countries since 2013-2014. Local bond markets accounted between 22% of GDP in Albania in mid-June 2016 to just below 1% of GDP in FYROM.

The small size and lower level of development of some capital markets may offer risk diversification advantages for foreign investors. An important factor for the liquidity of the bond market in the region is the participation of foreign portfolio investors. Crucial motives for their investment are interest rate differentials and - to some extent - exchange rate movements. Both factors have been shaping their participation in the CESEE government debt markets. Stock markets in the region, as is true for emerging markets more generally, show an upward trend in correlations due to both increasing global market exposures and a reduction in country-specific risks. In particular the larger, more developed equity markets have correlations with developed markets of nearly 80 per cent, and hence offer little diversification potential. On the other hand, many of the smaller markets, typically categorized as frontier markets, have correlations below 50 per cent, and do offer a scope for diversification. Still, for many investors the high transaction costs and illiquidity of the small CESEE markets may outweigh the potential diversification benefits.

2.4.2 The role of private equity

Private equity remains small in the CESEE countries as it does in the EU as a whole. Private equity is a medium to long-term option for companies that are in the early expansion phase and that are not listed on the stock exchange. It involves active ownership by investors, offering the possibility of drawing on management expertise, foster operational improvements and gain access to new markets. For start-ups, venture capital or business angels can be an appealing source of financing. Business angels, usually providing smaller financing than venture capital funds, are private high net worth individuals who directly invest part of their personal assets in new unlisted businesses. They typically bring industry knowledge and contacts to the entrepreneurs and take non-executive board positions.

Private equity investments in CESEE reached EUR 1.6 billion in 2015, concentrated in Poland, Serbia, Hungary and Romania. It compared to EUR 47.5 billion in the EU as a whole (Table 3). This is the highest value since 2009, nearly 25% above the 2014 level. Nevertheless, the overall amounts remain very modest. In relation to the size of their economies, private equity investment in the CESEE remains in most countries below the EU average (0.32 % of GDP). The larger private equity investments were observed in Serbia (0.68% of GDP) and Poland (0.21%).

Some CESEE countries perform rather well regarding the availability of venture capital. Especially in the Baltic states, Hungary, Poland and Slovakia this type of financing had some importance in 2015 (Table 3). In several countries venture capital investments benefited from public

support: e.g. in the Baltic countries by the public-private Baltic Innovation Fund. While amounts remain equally small, business angels are active and relevant in some CESEE countries (e.g. Estonia).

Table 3: Private capital investment in CESEE

(2015)	Private equity				Business angels EUR mio	Crowd funding EUR mio
	total EUR mio	% of GDP	of which venture capital EUR mio	% of total		
EU-28	47464.1	0.32	4400.0	9.3	443.4	5430.0
BG	46.1	0.10	1.1	2.4	4.3	na
CZ	13.8	0.01	1.7	12.1	na	9.0
EE	17.8	0.09	3.7	20.8	6.7	32.0
HR	9.0	0.02	1.2	13.3	0.4	na
LV	35.6	0.15	6.6	18.6	0.8	15.0
LT	48.9	0.13	9.9	20.2	1.2	na
HU	158.3	0.14	25.0	15.8	na	na
PL	887.4	0.21	19.6	2.2	12.4	10.0
RO	144.3	0.09	1.8	1.3	na	na
SI	11.4	0.03	1.4	11.8	1.9	na
SK	11.9	0.02	8.9	74.9	1.8	na
RS	229.1	0.68	0.4	0.2	2.1	na

Note: crowd funding includes peer-to-peer consumer and business lending

Source: [Invest Europe](#), [Eban](#), [Cambridge Centre for Alternative Finance](#)

Alternative forms of investment have been expanding in recent years. In 2015, alternative online financing, such as crowdfunding or peer-to-peer lending amounted to about EUR 80 million in CESEE with Estonia taking a large share of it (Table 3). Compared to the rest of Europe, where the activity is also concentrated in one country, namely the UK, the overall amounts remain small.

2.4.3 Household savings preferences and the availability of financial resources

The modest development of capital markets in CESEE has also to be seen against household savings preferences. The larger part of financial wealth of households in CESEE countries is directed to bank deposits (Table 4). This is especially the case for in Slovakia (62% of total financial assets) and Croatia (55%), with most CESEE countries staying above the EU average (30%). As corollary, equity, insurance and pension investments are below the EU average. There are, though, some notable exceptions for equity and investment fund shares which are popular in Estonia (52% of total financial assets), Bulgaria (42%), Hungary and Lithuania (both 40%). Investments into insurance or pension products are the highest in Croatia (24% of total financial assets), still below the EU average (39%), and the lowest in Romania (7%) and Hungary (9%).

Table 4: Breakdown of household's financial assets

% of total, 2015	Currency and deposits	Debt securities	Equity and investment fund	Insurance and pensions	Other
EU-28	30.4	3.1	24.4	39.3	2.4
Bulgaria	38.3	0.1	41.9	9.6	8.8
Czech Republic	50.5	3.7	28.4	13.0	4.4
Estonia	30.1	0.3	51.9	14.9	2.6
Croatia	55.1	0.2	17.6	23.8	3.3
Latvia	37.7	0.9	22.7	12.0	16.8
Lithuania	36.0	1.6	40.2	9.3	12.2
Hungary	28.3	9.5	40.1	8.5	10.7
Poland	47.9	0.3	25.6	15.2	10.2
Romania	35.3	1.3	24.4	6.7	32.1
Slovenia	50.0	0.3	26.2	17.2	4.6
Slovakia	62.3	2.5	8.6	19.5	6.9

Source: Eurostat

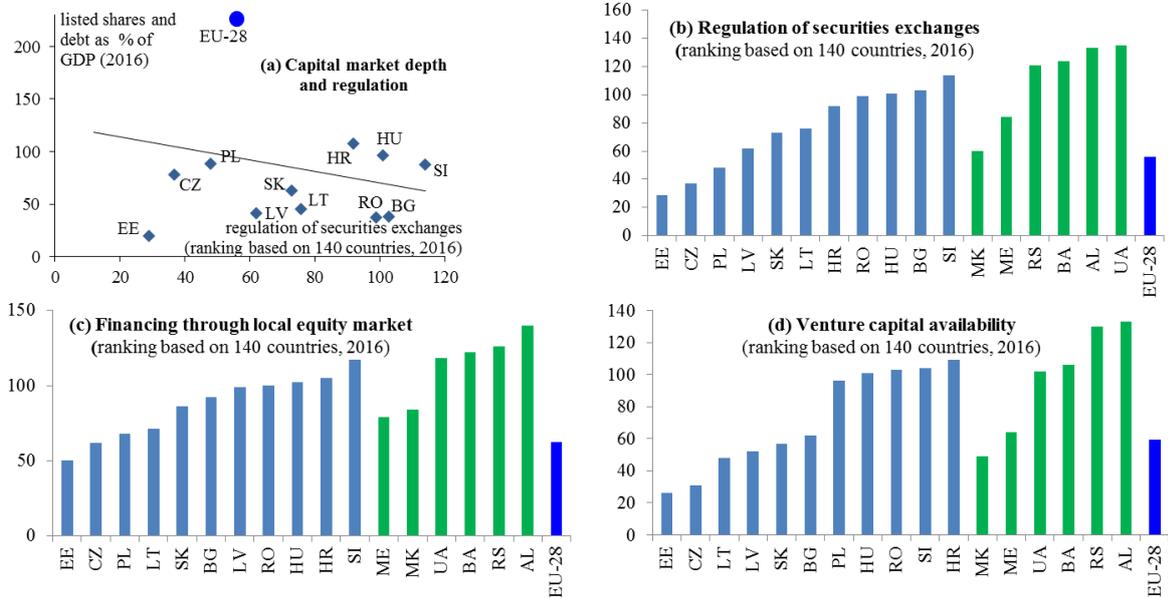
Besides disposable income that is generally lower in CESEE compared to other EU Members States, national regulatory frameworks also shape the savings patterns of households. In several countries of the region (including Bulgaria, Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia) reforms have been implemented to complement the state-organised pay-as-you go pension scheme with capitalised pension funds taking the form of sector-based and compulsory Pillar 2 schemes or individual Pillar 3 schemes. Recently, however, some of these measures have been modified in Poland, Hungary and Slovakia, making the Pillar 2 schemes less attractive and reducing the inflow of

new funds. In Hungary, for example, private pension fund assets have decreased on the back of the legislative changes in 2010 to 2012. In Slovakia, tax allowances were reduced as part of fiscal consolidation measures. In Romania, the government is discussing amendments to the Pillar 2 (i.e. a reduction in mandatory contributions or making the mandatory contributions to Pillar 2 voluntary), which would significantly impact the long-term sustainability of pension funds.

2.4.4 The regulatory environment and the supply of financial resources

The regulatory environment is crucial for capital market development. While not the only determinant, the better the ranking of countries in terms of effectiveness of regulation and supervision of securities exchanges, the deeper the capital markets are (Figure 12.a). Concerning equity markets in CESEE¹¹, market-specific laws as well as institutional reforms and economic openness foster their development. In this respect there is wide country variation, but most of the CESEE countries are ranked below the EU average (Figure 12.b). As a consequence, issuing shares on the local equity market is also more difficult (Figure 12.c). In response to the high transaction costs entailed by such issuances, junior markets have been set up by some stock exchanges to offer lighter listing requirements and lower compliance costs. An example is Polish New Connect which has allowed companies to raise cheaper funds at the IPO and benefit from lower listing fees afterwards.

Figure 12: The regulatory environment and capital market development



Source: World Economic Forum, ECB

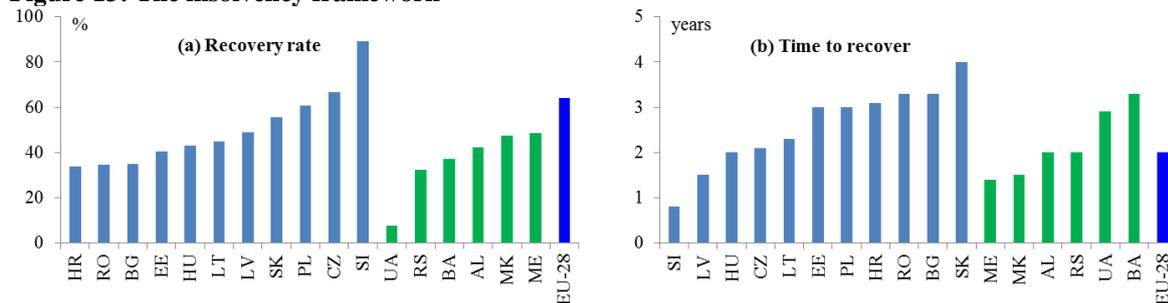
Concerning the availability of venture capital, some CESEE countries (the Baltic states, Czech Republic, Slovakia, Bulgaria, FYROM) seem to score rather well (Figure 12.d), thanks to public support and a favourable regulatory environment. This is encouraging given the importance of this financing channel for start-ups and innovative companies.

A performing insolvency framework is necessary for cross-border investment and to facilitate more predictable and orderly outcomes for corporate restructurings. Member States in the region have reformed and overall improved their insolvency procedures, but most countries still lag behind. When the average recovery rate from a liquidation of assets in the EU is about 65%, it is lower in several countries of the region (Figure 13.a). Also the time it takes to finalise an insolvency procedure is mostly longer in the countries of the region compared to an average of about 2 years in the EU

¹¹ L. Baele, G. Bekaert and L. Schäfer (2015). An anatomy of central and eastern European equity markets”, EBRD Working Paper No. 181, December 2015

(Figure 13.b). Swift transfer of ownership in case of default is a vital precondition for credit funds¹² (e.g. mezzanine funds¹³) to operate in CESEE markets.

Figure 13: The insolvency framework



Source: World Bank

2.5 Market infrastructures

Almost all countries in the CESEE region have a stock exchange.¹⁴ Each stock exchange has its central securities depository (CSD) for post-trading settlement. Most of the stock exchanges run separate multilateral trading facilities, usually as dedicated SME growth markets. Still, the local stock markets in CESEE differ significantly with regard to capitalisation and turnover. Figure 10 in section 2.4.1 above shows the level of development of stock markets in the EU relative to GDP. By this measure, Poland, Croatia and Hungary have the most developed capital markets. Their stock markets are also the largest in absolute terms (total capitalisation in EUR billions), matched by the Romanian stock exchange. The other markets in the region are significantly smaller (Tables 5 and 6).

Low liquidity of most local capital markets remains an important disincentive for potential issuers and investors. In 2015, in the majority of CESEE stock markets the share turnover ratio, measured as value of annual turnover divided by total capitalisation, remained below or close to 10%. Only in Poland and Hungary the average liquidity was significantly higher, with the ratios above 40%. In Ukraine it amounted to 27%. For comparison, the share turnover ratio of Vienna SE in the same year amounted to 33% and Athens to 52%¹⁵. Looking at the ratio of some of the largest European stock exchanges, it was 98% for Euronext, 97% for Deutsche Börse and 67% for Nasdaq Nordics and Baltics (including Estonia, Latvia and Lithuania)¹⁶.

Few countries in the region operate a central clearing counterparty (CCP). This is the case in Poland with KDPW, Hungary with KELER and Croatia with SKDD (Tables 7 and 8). The former two are compliant with the European Market Infrastructure Regulation on derivatives, central counterparties and trade repositories (EMIR), which establishes common organisational, conduct of business and prudential standards for CCPs and imposes requirements to improve transparency and reduce the risks associated with the derivatives market. The Croatian CCP is pending the endorsement for EMIR compliance by ESMA. In Romania, before the merger of the Bucharest Stock Exchange (BVB) and Sibex stock exchange, BVB possessed a clearing house, not compliant with EMIR, while derivatives traded on Sibex were cleared in Athens. In general, the post-trading environment in CESEE is fragmented and no efficient cross-border services are offered.

¹² An investment fund in which core holdings are fixed income investments

¹³ Mezzanine financing is a hybrid of debt and equity financing that gives the lender the rights to convert to an ownership or equity interest in the company in case of default. It is treated like equity on a company's balance sheet and to investors it offers relatively high returns in the form of interest.

¹⁴ Albania has none. Bosnia and Herzegovina has two.

¹⁵ FESE statistics, December 2015.

¹⁶ FESE statistics, December 2015.

Table 5: Stock exchanges in CESEE – EU member states (2015)

Country	Stock Exchange				Equities					
	Name	Majority owner	Regional cooperation	Supplier of trading system	Capitalisation	Turnover		Listed companies		IPOs
					EUR million	Total	Share turnover ratio	Domestic	Foreign	
						EUR million	%	Number	Number	Number
Bulgaria*	Bulgarian Stock Exchange (BSE - Sofia)	State	SEE link	Deutsche Boerse (Xetra)	4,417	156	4%	365	0	1
Czech Republic**	Prague Stock Exchange (PSE)	Vienna Stock Exchange	CESEEG	Deutsche Boerse (Xetra)	40,721	6,213	15%	15	10	1
Estonia	Nasdaq Tallinn	Nasdaq Nordic	Baltic Market	Nasdaq OMX (INET)	1,888	149	8%	15	0	0
Croatia***	Zagreb Stock Exchange (ZSE)	Diversified	SEE Link	Nasdaq OMX (OMX X-Stream)	16,834	387	2%	186	0	2
Latvia	Nasdaq Riga	Nasdaq Nordic	Baltic Market	Nasdaq OMX (INET)	1,277	45	4%	26	0	0
Lithuania	Nasdaq Vilnius	Nasdaq Helsinki	Baltic Market	Nasdaq OMX (INET)	3,339	75	2%	29	1	0
Hungary	Budapest Stock Exchange (BSE)	Central bank	-	Deutsche Boerse (Xetra)	16,246	7,005	43%	45	0	0
Poland	Warsaw Stock Exchange (WSE)	State	-	NYSE Euronext	123,659	56,256	45%	838	64	49
Romania	Bucharest Stock Exchange (BVB)	Diversified	-	in-house designed	17,027	1,865	11%	82	2	0
Romania	SIBEX	Takeover by BVB underway	-	Athex Group	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Slovenia	Ljubljana Stock Exchange (LJSE)	Zagreb Stock Exchange	SEE Link	Deutsche Boerse (Xetra)	5,523	340	6%	46	0	0
Slovakia	Bratislava Stock Exchange (BSSE)	State	-	in-house designed	2,119	6	0%	14	0	0

* Data on total equity turnover for Bulgaria (EUR 156 million) provided by the Bulgarian Stock Exchange

** Data provided by the Prague Stock Exchange

*** ZSE moved to the XETRA® trading platform in 2017. The first trading day on the XETRA® trading platform was 7 July 2017.

Source: EBRD (2016) Capital Market Infrastructure. CMI Facts & Figures 2015

Table 6: Stock exchanges in CESEE – non EU countries (2015)

Country	Stock Exchange				Equities					
	Name	Majority owner	Regional cooperation	Supplier of trading system	Capitalisation	Turnover		Listed companies		IPOs
					EUR million	Total	Share turnover ratio	Domestic	Foreign	
						EUR million	%	Number	Number	Number
Albania	Tirana Stock Exchange (TSE)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Bosnia and Herzegovina	Sarajevo Stock Exchange (SASE)	Commercial banks, Borsa Istanbul	link to Borsa Istanbul	Ljubljana Stock Exchange	40	1	3%	1	0	0
Bosnia and Herzegovina	Banja Luka Stock Exchange (BLBERZA)	Commercial banks	to join SEE Link	Ljubljana Stock Exchange	1,259	8	1%	31	0	0
FYROM	Macedonian Stock Exchange (MSE)	Private	SEE Link	Ljubljana Stock Exchange	1,664	32	2%	114	0	0
Montenegro	Montenegro Stock Exchange (MNSE)	Diversified, Borsa Istanbul	to join SEE Link	Ljubljana Stock Exchange	2,123	65	3%	60	0	0
Serbia	Belgrade Stock Exchange (BELEX)	Diversified	SEE Link	in-house designed	1,645	144	9%	8	0	0
Ukraine	Ukrainian Exchange	Diversified, Moscow Exchange	-	Moscow Exchange	3,281	126	4%	160	0	0
Ukraine	PFTS Ukraine Stock Exchange	MICEX Stock Exchange	CIS Exchanges	Nasdaq	6,924	1,889	27%	18	0	0

Source: EBRD (2016) Capital Market Infrastructure. CMI Facts & Figures 2015

Table 7: Other elements of capital market infrastructure - EU member states (2015)

Country	Multilateral Trading Facilities (MTF)	Central securities depository (CSD)				Central Clearing Counterparties (CCP) / Clearing Houses	Crowd-funding platforms	Rating agencies
		Owner	Bank licence	Participants				
				Domestic Number	Foreign Number			
Bulgaria		Banks and brokers 49.7%	no	113	1	0	0	BCRA
Czech Republic*	Prague Stock Exchange MTF, RM system MTF	Prague Stock Exchange	no	19	8	0	n.a.	0
Estonia	First North Estonia	Nasdaq Nordic	no	11	1	0	2	0
Croatia	Zagreb Stock Exchange's MTF	State + FINA	no	56	3	SKDD-CCP Smart Clear (pending regulatory approval)	3	0
Latvia	First North Latvia	Nasdaq Riga	no	17	4	0	0	0
Lithuania	First North Lithuania	Nasdaq Helsinki	no	41	16	0	1	0
Hungary	Beta Market	Central bank	yes	152	16	KELER - 90% owned by CSD; 111 members	3	0
Poland	Newconnect, Catalyst, Bondspot	WSE, NBP, MoF: 33.3% each	no	74	6	KDPW_CCP (owned by CSD). Clearing members: 36 on regulated market, 16 on OTC market.	8	Fitch Polska, EuroRating
Romania**	BSE SA	BSE	no	43	8	Bucharest Clearing House - owned by BSE (non operational)	2	0
Romania**	Monetary-Financial and Commodities Exchange - Sibiu SA	Sibex	no	8	0	Romanian Clearing House - owned by Sibex (licence withdrawn in 2015, derivatives cleared in Athens)	n.a.	0
Slovenia		Diversified	no	24	1	0	0	0
Slovakia	Bratislava Stock Exchange MTF	BSSE	no	16	4	0	0	European Rating Agency

* Data provided by the Prague Stock Exchange

** At the end of 2017, there was no derivatives market and clearing house in Romania.

Source: EBRD (2016) Capital Market Infrastructure. CMI Facts & Figures 2015

Table 8: Other elements of capital market infrastructure - non EU countries (2015)

Country	Multilateral Trading Facilities (MTF)	Central securities depository (CSD)				Central Clearing Counterparties (CCP) / Clearing Houses	Crowd-funding platforms	Rating agencies
		Owner	Bank licence	Participants				
				Domestic Number	Foreign Number			
Albania	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Bosnia and Herzegovina	n.a.	State	no	36	0	n.a.	n.a.	n.a.
Bosnia and Herzegovina	n.a.	State, banks, stock exchange	no	12	0	n.a.	n.a.	n.a.
FYROM	0	Private entities, diversified	no	10	0	0	0	0
Montenegro	n.a.	Central bank	no	20	0	n.a.	n.a.	BCRA-Credit Rating Agency
Serbia	MTP Belex	State	no	55	0	n.a.	n.a.	n.a.
Ukraine	n.a.	State, central bank	no	286	1	Settlement Center (owned by central bank, 210 members)	Uinvest	n.a.
Ukraine	n.a.							

Source: EBRD (2016) Capital Market Infrastructure. CMI Facts & Figures 2015

Three cross-border stock market cooperation clusters have emerged in CESEE. Including neighbouring markets in various parts of the region, these groupings differ also by the degree of integration, legal and operational structures.

- **Nasdaq Baltic Market:** the cooperation of stock exchanges in Estonia, Latvia and Lithuania is most advanced. As part of Nasdaq OMX group they form the Baltic Market, which aims to minimise differences between the exchanges stopping short of consolidation, facilitate cross-border trading and attract more investors to the region. Nasdaq Baltic Market is a common equities market with harmonized trading rules and market practices, single trading system, joint trading lists, harmonized indexes, single membership and single trading and settlement currency, allowing investors easy access to all Baltic listed financial instruments through any of the exchanges.
- **CEESEG:** the stock exchanges of Prague and Vienna are two subsidiaries of equal standing within a central holding company, CEESEG AG, which is responsible for the Group's strategic and financial management as well as for the administration of the subsidiaries. The business operations are run by the two member exchanges. Previously, also Ljubljana and Budapest stock exchanges belonged to CEESEG, but in 2015 they were sold to Zagreb Stock Exchange and the Hungarian National Bank, respectively.
- **SEE Link:** SEE Link is a project started by the stock exchanges of Bulgaria, Former Yugoslav Republic of Macedonia and Croatia with the objective of creating a regional infrastructure for trading of securities, supported by the European Bank for Reconstruction and Development. Ljubljana and Belgrade stock exchanges joined SEE Link in December 2016. In August 2017, the Sarajevo Stock Exchange and Banja Luka Stock Exchange connected to SEE Link. Athens and Montenegro markets are preparing to join. The idea behind this cross border initiative is to integrate regional equities markets without merger or corporate integration, using only IT technology that will enable participating stock exchanges to remain independent yet complementary. The objective is to allow investors easier and more efficient access to those markets through a local broker. The SEE Link is seated in Skopje.

The other markets in the region: Warsaw, Budapest, Bratislava and Bucharest are not part of any regional alliances. They cooperate with other exchanges by using their trading systems (supplied by Euronext for Warsaw and Deutsche Börse for Budapest) or arrangements for clearing derivatives (Athens' CSD for Sibex Stock Exchange before the merger with Bucharest Stock Exchange). Sarajevo Stock Exchange and Tirana Stock Exchange, before the latter was closed in 2014, cooperated with Borsa Istanbul.

The Warsaw Stock Exchange stands out by the relatively high growth dynamics and the share of international business. In 2015, it attracted 49 initial public offerings (17 in 2016), while in the majority of other markets no new issuances took place. Out of 902 listed companies listed on the Warsaw market in 2015, 64 were foreign, coming mostly from the neighbouring markets. Bucharest Stock Exchange had two foreign companies listed and Nasdaq Vilnius had one. However, WSE is facing significant issues following the pension system reform and the recent market trends. There has been a significant drop in market capitalisation and IPO activity since 2015.

3. Challenges and opportunities for capital market development

This chapter is based on inputs received from the Working Group members listed in the table below. In the first meeting of the Working Group, participants agreed to complete country surveys according to an earlier agreed template (Annex 2). The survey focused on challenges to capital market developments in individual markets and on potential solutions to address them. Each country section in this chapter follows the structure of the survey¹⁷.

Since the received submissions differed in terms of size and format, and given that the same country was often covered by surveys submitted by different participants, some editing work was necessary. The Commission as the Secretariat of the Working Group reviewed and streamlined the country sections while attempting to minimise changes and to keep the thrust of the participants' contributions. However, the size of the country sections still differs as it reflects the amount of received information. The Working Group members had the opportunity to comment and complement the draft in several rounds of intra-Group consultations.

This chapter includes sections only on those countries – members of the Vienna Initiative – whose representatives participated in the Working Group meetings and submitted the country surveys. They were eleven EU member states from Central, Eastern and South-Eastern Europe and one candidate country (Former Yugoslav Republic of Macedonia - FYROM).

Contributions received in reply to the questionnaire circulated following the first meeting of the Vienna Initiative Working Group on the Capital Markets Union (4 April 2017)

No	Country	Institution	Comment
1	Bulgaria	Stock exchange	
2	Bulgaria	KBC	Strategy for Development of the Bulgarian Capital Market (2016)
3	Czech Republic	Ministry of Finance	
4	Czech Republic	Capital market association	
5	Estonia	Stock exchange	
6	Croatia	Supervisory authority	Including comments from consulted market participants
7	Latvia	Ministry of Finance	
8	Lithuania	Ministry of Finance	
9	Hungary	Ministry of Finance	
10	FYROM	Supervisory authority	
11	Austria	Central bank	Focus on bond and equity markets. Covering AT and CESEE (only EU)
12	Poland	Ministry of Finance	Including comments from consulted market participants
13	Poland	Central Securities Depository	
14	Romania	Supervisory authority	
15	Slovakia	Ministry of Finance	
16	Slovenia	Supervisory authority	
17		AFME	Focus on insolvency regimes and taxation (EU11)
18		EBRD	Focus on structural features and proposed solution. Covering EU and non-EU CESEE countries
19		EIB	Investment Survey and CESEE Bank Lending Survey
20		Erste Group	Covering 6 countries: HR, CZ, SK, RO, HU, MK + horizontal issues
21		Raiffeisen Bank International	General comments on CESEE markets
22		EIOPA	Statistical information on CESEE markets
23		World Bank	Information on consumer protection in capital markets

¹⁷ Standard headings were kept even if no information was submitted thereunder.

3.1 Bulgaria

Based on contributions received from the Bulgarian Stock Exchange, EBRD and KBC.

a) Challenges and impediments to capital markets development

Structural

- The Bulgarian capital market is **among the smallest EU regulated markets** with a total market capitalization of EUR 5.58 billion which amounts to 11% of Bulgarian GDP. It is dominated by SMEs; out of 359 stocks currently admitted to trading on the stock exchange only 4 would not be classified as SMEs according to the SME definition in Markets in Financial Instruments Directive II (MiFID II).
- Even though there are **large and long-term investment resources available in Bulgaria** such as those accumulated by pension funds (more than EUR 5 billion), insurance companies and mutual funds), due to low liquidity and regulatory constraints of the local capital market, a considerable part of these resources is invested outside the country.
- There is an **insufficient pool of institutional investors**. The local non-banking sector is relatively small with net assets under management of mutual funds and pension funds totalling EUR 530 million and EUR 5.5 billion respectively. There is also a lack of issuer-specific information, especially in English. Due to all local structural impediments, the percentage of local issuers that make their company disclosures in English is relatively small compared to the European average.
- Daily **equity market** turnover is very low and on average amounted to EUR 0.72 million in 2016 (EUR 0.64 million in 2015). It is projected that over 30% of the theoretical free float of the market is currently held in dormant accounts which constrains secondary market activity and could have a negative impact on corporate governance.
- When it comes to the bond market, larger entities such as state energy companies tend to access the Eurobond market for finance and a small number of BGN denominated corporate and municipal bonds are listed on the Bulgarian Stock Exchange. There are currently 59 corporate bond issues listed on the Exchange – 41 are EUR denominated (total nominal value of EUR 404 million) and 18 are BGN denominated (total nominal value of EUR 81 million). Secondary market turnover is low and tends to be transacted OTC.
- In addition, there is **no EMIR-compliant Central Counterparty (CCP)** in place although market participants currently support the initiative towards a regional CCP. In addition, regardless of the interoperability obligations stemming from Central Securities Depositories Regulation, many foreign CSDs have no motivation and resist setting up post-trading links with Bulgaria given the size of the market.
- Finally, there is **insufficient research coverage** of the local public companies.

Regulatory

- **Corporate governance** and minority shareholders protection standards are low in Bulgaria compared to the EU average.

Supervisory

[...]

Cultural

- The local **non-bank investor base** is very small and a large percentage of consumers hold their savings in banks despite historically low interest rates. There is a lack of equity culture and of interest in the capital market of individual investors. Savers and potential investors are risk-averse and local companies prefer bank loans than equity or bond financing.
- There are also **historical reasons behind the weak capital market** in Bulgaria. More than 1000 Bulgarian public companies were listed on the stock exchange as a result of the mass privatisation

process in the country in the end of 20th century. The obligatory listing had the following negative effects:

- low levels of corporate governance in most of the companies;
- liquidation and insolvency procedures in some of the companies as a result of their restructuring;
- delisting from the Exchange of majority of the companies.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- The Bulgarian Stock Exchange aims to **improve its administrative and institutional capacity** and to implement structural reforms regarding local capital market by making use of the financing available through the Structural Reform Support Service for 2017-2020.
- In parallel, the government adopted the **Strategy for Development of the Bulgarian Capital Market** in November 2016 which identifies and proposes a number of actions as structural solutions to the above-listed problems:
 - Increase the variety of financial instruments (FI) that are traded on the Bulgarian Stock Exchange (BSE), e.g. by enhancing the quality of existing instruments, by improving regulatory framework, by encouraging issuers and majority shareholders to increase the volume of free float, by privatising large state-owned companies through the capital market, etc.
 - Facilitate financing of public offerings of financial instruments (both IPOs and SPOs) through operational programmes and EU funding (e.g. through Operational Programme 'Innovations and Competitiveness' 2014-2020).
 - Development of a web-based single entry point for disclosure and distribution of information by market participants to capital market institutions.
 - Incentives to small and medium size businesses to raise capital through the capital market. In order to facilitate the access to capital for smaller and medium-sized enterprises, the Bulgarian exchange is working on a project to introduce an SME private market for companies to raise up to EUR 1 million with no requirements for approved prospectus. The requirements for authorized advisors that are among the prerequisites for setting up the market will be detailed in Q4 2017. In addition, an SME Growth market will be discussed as a potential option for the Bulgarian exchange in the MiFID II environment.
 - Establish opportunities for Bulgarian investors and issuers to access, via the Bulgarian Stock Exchange, foreign markets, including listing on such foreign markets. The project named BSE International is related to the establishing of a new market on the Exchange which will allow domestic trading in up to 75 foreign financial instruments that have been already admitted to trading on other regulated markets. The settlement will be done by Clearstream Luxembourg which has a direct link to the Bulgarian CSD. The project consists of two main phases and its first phase is expected to go live in the third quarter of 2017:
 - a. establishing of a regulated market segment for instruments with EU-compliant prospectuses;
 - b. establishing of an MTF for all other instruments.
 - Facilitate the settlement procedures within the SEE Link platform. The proposed solution includes settlement in the respective local CSD based on standardized instructions exchanged between an investment firm that has accounts in all regional CSDs, the SeeLink brokers and the CSDs.
 - Re-activate dormant accounts holding shares acquired from the mass privatization by launching a relevant campaign informing accounts' holders about available opportunities for disposal. Specific measures enabling the disposal of assets (sale, inheritance, etc.) in an economically effective manner for their owners would have to be adopted.
 - Launch of a secondary market for trading in government bonds on the BSE. It will provide an easy access of retail investors to secondary trading in these instruments according to the rules of the stock exchange. The settlement will be done by the Bulgarian Central Bank and the Bulgarian CSD. The expected launch of the new market is the end of Sept 2017.

- Access to services for clearing of mutual obligations at a central counterparty (CCP). It would have to be explored whether an existing EU clearing institution could provide access to CCP clearing services.
- Develop an infrastructure for trading in financial derivatives.
- Establish a single system for lending of financial instruments (lending pool). Such system would facilitate the settlement of short positions and would guarantee settlement when financial instruments are lacking.

Regulatory

- Progress was made on the regulatory side with the approval of the amendments to the **Bulgarian Law on Public Offering of Securities** by the Bulgarian Parliament in July 2017. The main changes aimed at:
 - facilitating the access of SMEs to the capital market;
 - speeding up the listing process;
 - creating robustness and predictability in corporate debt market;
 - introducing legal framework regarding semi-annual dividend distribution by public companies;
 - easing the regulatory requirements regarding the publication of a notice for the beginning of an initial public offering aiming at reducing the IPO costs;
- There are also other measures proposed by the **Strategy for Development of the Bulgarian Capital Market** that can be classified as regulatory. The objective is to attract foreign and domestic investors by:
 - Improving and harmonizing the regulatory framework with the EU legal framework;
 - Providing new services, and ensuring that core services are provided in compliance with the international best practices;
 - Modernizing and developing market infrastructure, including the trading platform, the clearing and settlement system, the registration system, the corporate action processing system to enhance the efficiency and transparency of transactions;
 - Active advertising of the capital market outside the country by the government;
 - Shortening administrative procedures, e.g. for registration of a subscribed issue of FI after a public offering, etc.
- Exploring, organising and facilitating the possibility for **funding of infrastructure projects** through the capital market.
- Exploring the possibility and developing a roadmap for accession to the European securities settlement engine, **TARGET2-Securities** (development of a single European system for clearing and settlement of transactions in financial instruments).

Supervisory

[...]

Cultural

- The Bulgarian Stock Exchange organises a number of activities to **enhance investment culture** and knowledge of financial instruments in Bulgaria. In addition, the Strategy sets several objectives aiming to improve the understanding of capital market, enhance financial literacy and incentivise SMEs' participation by:
 - Introducing additional specialised courses in the educational institutions;
 - Organizing seminars and financial forums;
 - Providing training courses by media;
 - Encouraging the organisation of specialised university courses
 - Encouraging publishing of stock exchange information in media, etc.
- The Stock Exchange conducts an awareness campaign at various levels to explain the mechanisms of operation of the financial market (its operation, services and access, services of investment intermediaries, pension system, insurance services, etc.)
- It promotes and supports measures to raise the level of domestic savings including pension funds.

3.2 Czech Republic

Based on contributions received from the Ministry of Finance, the Czech Capital Market Association, and Ceska Sportitelna (member of Erste Group).

a) Challenges and impediments to capital markets development

Structural

- The **capital market in the Czech Republic** is small (market capitalisation in 2015: EUR 50 billion), also because the Czech economy is small (GDP in 2015: EUR 207 billion). Based on market capitalisation per capita (in 2015: EUR 4,724), the Czech Republic ranks high among the countries in the region, surpassing Poland (with market capitalisation per capita: EUR 4,061) but behind Croatia (market capitalisation per capita: EUR 4,777). But from among the other EU Member States, the Czech Republic only is ahead of Greece (market capitalisation per capita: EUR 4,355) and trails all other Member States (ranging from Portugal: EUR 6,476 to Luxembourg: EUR 92,662).
- The **ownership of most companies** is concentrated, with one majority shareholder (this is based mainly on anecdotal evidence of various companies from voucher privatisation, there is no complex study in this regard). Many businesses are also family owned. Most of the companies were privatised during the voucher privatisation or direct sale in 1990s, so there are not many state-owned companies left.
- The **savings** amount to satisfactory levels (gross domestic savings in 2015: EUR 69.44 billion; 33.5 % of GDP), also the savings rate is satisfactory (gross savings in 2015: EUR 55.78 billion; 28.79 % of GNI - from EU only IE and LU exceed this savings rate). There are substantial savings at institutional investors (EUR 17.6 billion in pension funds, EUR 21.5 billion in life insurance and EUR 51 billion in banks), but for various reasons large portion of these savings does not find its way to capital market (real economy). For example from the data collected by the World Bank, it seems that only 6.29 % of available funds of banks is directed to the real economy (loans are excluded; loans to customers represent 56.55 % of available funds of banks) and in relation to pension funds (“transformed funds”) only 0.12 % of assets is invested in equity, 1.85% is invested in investment funds and 12% in private sector bonds. One of the reasons why banks are not willing to invest in more significant investment activities may be their historically high rate of fee and commission income (CZK 44.7 billion last year). However, these earnings have steadily declined since 2011 (CZK 50 billion) and it should therefore be in the best interest of banks to look for further revenue paths.
- The **costs for IPO** are considerable, but not too high - for example an equity prospectus may be prepared for EUR 10,000. When not taking into account agriculture, financial institutions and public services (NACE A, K and O), in 2015 in the Czech Republic there were 1,640 large sized enterprises with average assets of CZK 2.7 billion (EUR 100 million), 6,794 medium sized enterprises with average assets of CZK 306 million (EUR 11.3 million) and 241,650 small sized enterprises with average assets of CZK 17.8 million (EUR 660 thousand). It does not seem that small sized enterprises dominate the Czech economy based on the amount of the assets held by each category in total: large (250+ employees) EUR 164 billion, medium (50-249 employees) EUR 77 billion, small (0-49 employees) EUR 160 billion.
- In general, the **banking market** is over-liquid. Most of the largest companies are foreign owned and thus funded via Treasury Centres of the mother companies or through cheap banking loans. Opportunity for large size DCM financing created mostly on the back of M&A or recap financing.
- Limited **number of investors**: institutional investors focused on liquidity, almost no investors willing to invest into small cap companies – i.e. listing is real option only for larger companies providing sufficient free float. Retail investor base is limited, and mostly focused on investing abroad.
- On **fixed income** side: institutional investors are heavily regulated, highly credit averse, currently piling cash because of lack of domestic investment opportunities and low interest rate environment
- Almost no domestic **secured or covered bonds** due to liquid banking sector. Real-estate projects financed by bank market only. Banks invest in bonds SSDs due to lack of assets.

Regulatory

Implementation of EU regulation

- The law of capital market is mainly EU harmonised, with lot of regulation coming in recent years (e.g. EMIR, MAR, MiFID2, MiFIR, benchmarks, GDPR). Especially in recent years the **regulatory burden** is overwhelming, with lots of resources being consumed by compliance costs. Lack of regulation is not viewed as a problem, also for example in relation to FinTech and crowdfunding. Not much is left for national regulation (not harmonised by EU law). But for example some stakeholders have mentioned the areas of corporate law, insolvency law and securities law as those where further harmonisation may be beneficial.
- Widely differing EU and national **rules on asset segregation, registration and post-trade reporting** requirements create inconsistencies and unnecessary costs to all actors in the EU financial markets. Public authorities need to better coordinate these rules at pan-European level to achieve better harmonization and integration across the region.

National rules and taxation

- Lack of standards for **corporate actions processing**. The Czech CSD processes corporate actions, dividend and coupon payments and tax reclaims related to these payments, rights issues and tender offers. To process these services, investors (typically represented by their local custodians) contact issuers (typically represented by a paying agent appointed by the issuer). As a result of this market arrangement, processing and documentation standards differ according to the issuer. This shows up most often when processing a tax reclaim – some issuers demand different documentation than others. Another example is a tender offer where all existing shareholders of a company have right to participate, but an offering party (related to the majority shareholder) defines tender offer conditions in a non-standard way (by defining very strict and formalistic documentation requirements and extremely short cut-off time for providing these documents). This in effect means that while formally minority and foreign shareholders have the same rights as majority or local shareholders, in practice this lack of standards for processing of corporate actions results in certain groups of shareholders having substantial higher risk of not being able to exercise these rights.
- **Rigid account structures**. Czech law does not recognize the concept of nominee ownership or nominee account. Czech law recognizes two types of securities accounts for book-entry securities: and “owner’s account” and a “clients’ account”. This situation is unsatisfactory for several reasons:
 - There are at maximum two levels (either the “owner’s account” is opened on the first level - in CSD, or on the second level – in the books of the holder of the “clients’ account”). This does not always allow for efficient settlement and holding arrangements.
 - When an intermediary opens a “clients’ account” in CSD and opens “owners’ accounts” in its books, then it follows from Czech law that this intermediary must have a direct contractual relationship with all owners of the “owners’ accounts”. This is not flexible enough because often it is the case that the intermediary is a local custodian, and beneficiary owners are not his direct clients. Beneficiary owners may be clients of a global custodian who is a client of the local custodian.)
 - In addition, opening of a “clients’ account” in CSD results in substantial reporting requirements.

Supervisory

- Insufficient possibility to **enforce rules on foreign entities** (passporting entities) is mentioned as something to focus on. Also for example in relation to criminal law, the lack of skills particular to financial market is mentioned as an issue for general courts and police forces.

Cultural

- There is strong **preference of entrepreneurs to use bank credit** as the primary financing tool, not using the capital market to its full potential. This is supported by general preference of banks to provide loans instead of arranging issuances of corporate bonds. The equity culture was also damaged to a significant level by voucher privatisation, where lack of supervision before 1997 resulted in several wide-reaching scandals of fraudulent behaviour. This led to a wide-spread distrust in capital markets. This can be also supported by very low investor-relation and governance culture within some companies which were listed during the voucher privatisation. This is because the privatisation decision was taken at central level by the government, and not by the management of these companies (non-voluntary listing).
- No real **privatisation via Prague Stock Exchange (PSE)** – no support from the state.
- Growing interest of **private banking and high net worth customers** in the investment into bonds, though at slow pace.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- **Incentives for local institutional investors** to invest into local equity markets.
- **Pension reform** creating long-term savings which can be invested into bonds and equities. Some fine-tuning of legislation for pension funds is necessary. Also any further discussions on 2nd pillar pension funds are of vital importance.
- Liberalization of the **regulatory limitations for the investments of institutional investors** (insurance companies) - currently investment into securities listed on regulated market allowed only.
- In the near future, CEE capital markets will have to absorb issues of “eligible liabilities” of banks domiciled in CEE. However, most banks have made limited use of capital markets due to the abundance of deposits. The current stage of capital markets might be a limiting factor, also constraining lending activities by banks not able to meet their **minimum requirement for own funds and eligible liabilities (MREL)**. MREL will likely lead to “cross-investment” within local banking sectors (however it is still not clear whether such cross investment will be accepted by regulators).
- **Using EU structural funds to support listing of local SMEs** on PSE (e.g. coverage of transaction costs, co-investments by state funds – now state focusing only on private-equity style investments). The problem of SMEs IPOs was to certain extent tackled in new Regulation of Prospectus (so called “SME Growth Prospectus”). The Communication on CMU Mid-Term Review also expects some action in relation to pre-IPO. Each Member State should analyse possible solutions to its structural problems which can be solved at national level.
- Even a partial **privatisation through public capital market** (for example 20 % of shares) would have significant benefit for the capital market. It could also help the Czech Republic to be classified as Developed Market by MSCI - for this we would need 5 issues with market capitalisation over USD 2.538 billion, free float over USD 1.269 billion and security liquidity over 20% AVTR (in relation to GNI per capita, the Czech Republic satisfies the criteria).

Regulatory

Implementation of EU regulation

- The Czech Republic welcomes very much the initiative of the Commission “**Call for Evidence: EU regulatory framework for financial services**” and all follow-up actions in this regard (for example: EMIR review, CRR review, proportionality of prudential rules for investment firms, etc.). Taking into account the planned revision of Dodd-Frank Act in USA, EU should not stay behind in this regard, while sustaining the necessary role of prudential regulation in safeguarding financial stability.

- In relation to **FinTech** solution, the possibility of “regulatory sandboxes” is often discussed. The Czech Republic supports these discussions and proposes that some “de minimis” rule can be included in many regulations. As example can serve Prospectus Regulation and Art. 3 of AIFMD (2011/61/EU).
- **Investor protection** rules may be revised. Nowadays investor receives large amount of information, which is difficult for him to read and understand. Investor should only receive a limited amount of information (“key information”) with the possibility to receive more information on request.
- **Proportionality principle.** Introduction and application of the principle of proportionality with regard to the obligations laid down by European law on market participants would improve the functioning of the capital market in the Czech Republic. With regards to the size of the institution / jurisdiction / relevance of the issues regulated in various jurisdictions, the proportionality principle should be introduced. Example where the status quo could lead to severe damages to the CEE markets: MiFID II sanctions. With regards to the size of local players, financial sanctions under MiFID II, may be liquidating for market participants.
- **Timely preparation of the EU legislation.** Introduction of a rule that European law cannot take effect earlier than one year after the delivery of all levels of European legislation to the market participants (in a detail that is needed for a proper implementation). Otherwise, in smaller jurisdiction, with smaller market participants, it is problematic to timely implement the current amount of EU legislation and the risk and cost of such approach are so high that they are damaging the business.
- **Implementation support to small jurisdictions.** Such as the preparation of practical "instructions, roadmaps and TO DO lists" for the implementation of European regulations targeted at individual jurisdictions and types of financial institutions could be provided at the EU level. This would help mitigate the regulatory burden and could enable focusing more on business, than on the implementation of the EU legislation.
- **Post trade securities services** and the European Post Trade Forum. A key priority for CMU is in post-trade. The Czech Republic hopes that the Commission will take forward an ambitious agenda to address inconsistency and often conflicting laws in relation to clearing, settlement and custody processes. These aspects together will allow for a very significant enhancement of the operational risk framework in the post-trade services industry, leading to more attractiveness of the EU financial markets, more efficient use of capital, technical and human resources and an overall safer and more resilient operating environment in Europe.
- The Czech Republic welcomes the actions that the Commission intends to include in its CMU Action Plan at the end of 2017 addressing some long-standing structural issues, such as **withholding tax collection procedures and asset segregation**, which represent practical impediments.

National rules and taxation

- Support from and **interest of government** in the development of local capital markets and its liquidity (such support was provided in the crisis only in the form of retail targeted “government savings bonds”).
- **Lighter regulation for smaller companies** – a Multilateral Trading Facility (MTF) system (with light requirements) does not really help, as most local investors are not willing / able to invest there (only willing to invest into regulated markets).
- **Lighter regulation for institutional investors** in respect of investments into regulated markets in order to allow for true “Catalyst/MTF” market with less approval and reporting burden and efficient trading/settlement platform.
- Adoption of **standards for processing of corporate actions** (dividend and coupon payments, tax reclaims related to these payments, rights issues and tender offers) to ensure effective protection of minority and foreign shareholders in the Czech Republic.
- Introduction of a **nominee concept for securities accounts.** Introduction of a nominee concept, compatible with recognized international standard, would help to improve efficiency of the market without compromising asset safety.

Supervisory

- Regulators/supervisors to adopt **faster and flexible approach** and concentrate on legal requirements.
- The ongoing discussions on **supervisory powers of home and host competent authorities** are important and valuable. Any change to the current system must be properly analysed. The supervision is functioning quite well, including continuous supervisory convergence through the activities of ESAs. In our opinion the current system works well and there is little room for improvement.

Cultural

- The Czech Republic has been a full member of the International Network for Financial Education (INFE) within the OECD since its launch and will follow OECD recommendations and new trends regarding areas of financial literacy and target groups. The Czech Republic is in the process of revising the National Strategy for Financial Education on the basis of OECD recommendations and a national consultation process. The Czech Republic also participates in the Subgroup on Financial Literacy meetings led by Croatia.
- Even though any change to the mindset of ordinary people is a long run endeavour, it is not a complete waste of time. The Czech Republic therefore supports **continuous financial education of retail investors, and business education of potential issuers (mainly CFOs of SMEs) and equity researchers**. In the end any peer-pressure is important to achieve a visible impact, but the “soil” (minds) must be ready to accept any “seeds” of new ideas. FinTech example shows in many cases that especially young people are open to new, innovative ideas. Further proof that people are able to adopt new technologies and ideas is that the Czech Republic is on the first place in the use of contactless payments in Europe.
- Some **successful privatisation via capital market** that would increase profile of PSE among retail investors.

3.3 Estonia

Based on contributions received from Nasdaq Tallinn and EBRD.

a) Challenges and impediments to capital markets development

Structural

- **The Estonian capital market** remains small and illiquid and the banking system remains dominant. The establishment of a unified exchange – NASDAQ Baltics covering the stock exchanges in Tallinn, Riga and Vilnius is likely to lead to further harmonization of the three markets and attract more investments to the Baltic region. Given the small size of Estonia it seems likely that a regional approach may be needed for creating an inventory of financial products such as covered bonds, investment funds and securitization products. Estonia has also shown a keen interest in developing niche financing markets such as venture capital and FinTech financing hubs as it is already one of the frontrunners in the digital market and in cybersecurity in the European Union.
- Estonia lacks a **government bond market** and the commercial bond market is poorly developed. Conservative fiscal policy of the Estonian government has resulted in very limited issuance of government bonds in the past and Estonia has presently no outstanding government bonds. The government last accessed the debt markets in 2002 and for the time being does not plan to issue further bonds. There are a small number of large corporations, whose financing needs are largely serviced by available bank credit. Any bond financing needs are met by the Eurobond market. Estonia is keen to explore the issuance of securitization and covered bond products but its small size, highly concentrated regional banking system and the limited inventory of high quality assets such as mortgages and credit card receivables suggest that an aggregated regional Baltic product is probably the most viable.
- The Estonian **equity market** is divided into 2 major segments: the regulated and non-regulated market. Additionally, there is a non-regulated OTC Market, which is not centralized and trading volumes are difficult to evaluate. The stock exchange capitalisation has decreased and the volume shrunk considerably since 2007. IPO activity peaked in 2005-2007 when Estonia was starting to benefit from EU membership but the volume has now tapered off to one to two new issues per year.

Regulatory

Implementation of EU regulation

[...]

National rules, insolvency framework and taxation

[...]

Supervisory

[...]

Cultural

[...]

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- The general financing needs of Estonia are largely met by the banking system and Eurozone capital markets so **niche market development** is a priority (support further development of market segments such as FinTech financing, covered bonds and securitization).

- Availability of the **capital pool** is critical for SMEs: for example establish a co-investment fund with anchor investors (e.g. EBRD).
- **State-owned enterprises**: focus on listing large enterprises + increase of free-float through secondary offerings of the listed ones.
- Support development of **pension funds and expansion of the local institutional and private investor** base. Channel a greater share of domestically accumulated pension assets into listed equity.
- Support enhancement of the private sector competitiveness through **innovation**. Encourage reforms to enhance the effectiveness of innovation policies in order to raise the image of Estonia as a financing hub for new technology businesses.
- Improve the availability of **various types of equity investment** into expanding SMEs. Foster development of private equity and venture capital. Support development of financing mechanisms like crowdfunding and peer-to-peer financing.

Regulatory

Implementation of EU regulation

- **Compliance**: conduct a critical assessment of the compliance costs and administrative burden on listed companies, intermediaries, retail funds, etc.

National rules, insolvency framework and taxation

- Turning retail “savers” into “investors”: introduce **tax incentives for long-term investments** in equity, investment accounts, listed alternative investment vehicles.
- Implement **legal framework for covered bonds and securitization**, concentrating on Baltic regional solutions.

Supervisory

[...]

Cultural

- **Financial literacy**: elaborate EU-wide and/or EU-funded national educational campaigns promoting financial literacy and equity culture.

3.4 Croatia

Based on contributions received from Hanfa – Croatian Financial Services Supervisory Agency, Erste&Steiermaerkische bank d.d. (member of Erste Group) and EBRD and AFME.

a) Challenges and impediments to capital markets development

Structural

- **Croatia** has a **bank-centric financial sector** with a low level of knowledge by local companies on potential capital rising opportunities through capital markets. As of June 2015, banking sector assets accounted for 72.6% of the total financial sector assets. The largest institutional investors were the pension funds with a share of 11.9% of the total financial sector assets, followed by insurance companies with a share of 5.7%. The remainder of financial sector assets was held by intermediaries, money market funds, non-MMF investment funds, financial auxiliaries and captive financial institutions.
- The **Croatian capital market** is small with many companies lacking financial literacy. The bulk of equity market capitalization is concentrated in a few stocks. The **stock market** is heavily reliant on three brokers, which account for more than 50% of turnover. At the beginning of 2017, the equity market was significantly impacted by the difficulties experienced by the Agrokor Group, one of the biggest industrial groups in Croatia, which was put under extraordinary administration. Although the Agrokor Group is privately owned, it has several Zagreb-listed subsidiaries, impacting therefore the overall trading volumes and retail investor sentiment.
- The Croatian CSD's subsidiary, SKDD-CCP Smart Clear d.d. is currently subject to a licensing process as a CCP under EMIR. The local CCP is "cash market only" and (currently) has no cross-border activity, but the high regulatory and capital requirements will likely increase the cost of service related to clearing in the Croatian cash market.
- The **corporate bond market** remains underdeveloped and underutilised as a financing option. In general, the Croatian bond market is characterised by an overwhelming dominance of government bonds (issued in local and foreign currency on the domestic and international capital markets). Listed corporate bonds include a mix of municipalities, electricity distribution companies, banks and a few non-financial corporates. The market is largely buy-and-hold with secondary market turnover for 2016 being negligible.
- The lack of **private equity, venture capital** and **business angels** is also an important aspect. **IPOs** are virtually non-existing, although there are several state-owned companies, but the government is reluctant to proceed with a sale or to do an IPO. Most of the privatizations are done with strategic investors or domestic pension funds. Mandatory pension funds are the main institutional investors although their investment strategies are not sufficient to provide the needed boost to the market liquidity. Since 2016, crowdfunding activities have appeared as a new way of raising capital, although the number of campaigns has been limited. Several incubators set up by angel investors started their activities, but with limited number of successful investments so far.

Regulatory

- The **regulatory framework** is well developed and enforced, although in some cases it is assessed by market participants as being burdensome. More specifically, the "one-size-fits-all" model, which is primarily used as a model for the EU level regulatory framework, is in many cases less proportional for smaller markets. It brings excessive and disproportionate requirements and costs for providers of services on these markets, thus making them less competitive. Furthermore, many market participants note that the EU *acquis* (directives and regulations) is becoming increasingly complex and demanding.
- Many small investors assess **tax-related issues** as being too restrictive. Companies report **frequent changes in tax policy** and the lack of a clear timeframe for issuing binding opinions on tax issues as affecting the predictability of the business environment in Croatia. Regarding the horizontal aspects regarding the **tax system**, efforts have recently been made to modernize the **tax administration**, although these are considered to have had limited effect in practice so far. Croatia

used to have a tax exemption for capital gains arising from the sale of shares (however, this was replaced by a 12% tax rate from 1 January 2016).

Supervisory

- The supervision of financial intermediaries has become more challenging due to the increasing number of requirements imposed by new EU legislation. This can be disproportionate in the cases of supervision of small market participants offering non-complex services. The biggest problem in strengthening its capacity is hiring staff with adequate skills and business experience as HANFA cannot match competitive salaries.
- When supervision leads to the involvement of the judiciary authorities, the process leading to a final court decision proves to be very lengthy.
- In 2015, HANFA launched the “loosening of administrative burden” project through the introduction of a digitalized data exchange between the regulator and the supervised entities for a majority of their submissions, thus reducing time and costs spent by entities in fulfilling their reporting obligations. In addition, HANFA decreased some of the fees charged for either licensing or supervision of the entities.

Cultural

- The capital market as an alternative to **bank financing** is still not seen as an option by many companies and diversification is not sufficiently valued. Entrepreneurs prefer **debt financing** and typically banking loans. Equity is not often the manner chosen for financing projects. Furthermore, companies consider that accessing capital markets is still too expensive. Since the perceived value added of capital markets is low, the cost related to the necessary advisory services (for instance, legal advisors, auditors) is assessed as being too high.
- In 2016, a financial literacy survey was carried out by HANFA and the Croatian National Bank in cooperation with the Ministry of Finance in line with OECD methodology. The survey results showed a relatively low level of financial literacy in general, but particularly in the younger population.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- A **stronger role of EU structural funds and cross-border projects** may be used as possible options for development of smaller markets. These funds may be used for a number of goals such as investor education programs and incentives for SMEs and start-ups. An SME market implementation case study is a great example of cross-border projects. The support could additionally be used in various levels of market education: educating large companies about transparency and corporate governance, educating SMEs about listing in an SME market (benefits and obligations, establishing corporate governance and investor relation functions – longer lasting programs), educating retail population about the financial culture, markets, and instruments in general.
- **Consultancy project** with the Croatian Government to develop a strategic view for capital market development
- As an example, an EBRD sponsored project in cooperation with HANFA and the Zagreb Stock Exchange (ZSE) on the corporate governance code was recently initiated in order to improve the reporting practices by listed companies.
- Also, the SEE link project was started by ZSE in cooperation with other regional exchanges.
- In 2016, ZSE initiated the Funderbeam SEE project, a crowdfunding platform for startups that investors can use to trade their shares on, immediately after their initial investment phase. This platform provides both a primary and a secondary market for investors. This platform will focus on companies from Croatia, Slovenia and Serbia, and plans to expand to the wider region.
- ZSE and EBRD also launched the SME Growth Market Project with the aim to increase access of local SMEs to local capital market financing through the development of a regional SME

financing platform. Such projects on national and cross-border level should be further developed and supported in order to create financing and growth opportunities for local and regional companies on local and regional capital markets.

- The **SME IPO initiative** should find a way to reduce costs – regional government bodies to co-finance the SME listings to encourage regional entrepreneurship development.

Regulatory

- **Harmonisation** of the upcoming and revision of current regulation on capital markets, to ensure more flexible deadlines for implementation and use of the regulation for investment firms (which complies with the relevant EU provisions), market venues and other capital markets participants.
- Enact the **legal framework for covered bonds**, which is still in preparation. In Croatia, debt securities are regulated by the Capital Market Act. However, particular types of debt securities are not regulated by any other law, except for corporate bonds, which are regulated by the Companies Act. Covered bonds are currently not specifically regulated.
- Reform to create a **positive tax environment for companies**, and in particular SMEs, for raising funds on the capital market and for investors.

Supervisory

- Reducing the **administrative burden** is of great importance, while experience obtained through the CMU project will be of great interest for various Member States as there is no unique solution for streamlining this burden, and each MS has its own approach. Exchange of information on best practices on dealing with the administrative burden in different Member States would be useful for all stakeholders.
- Improve adherence of listed companies to the **Corporate Governance code**.
- Continue and further develop **communication between the supervisor and capital market participants** regarding amendments to relevant regulation in terms of organizing workshops, seminars, Q&A and other forms of multilateral communication. For 2017, positive examples are a structured series of workshops organized by HANFA on MIFID2 and IDD related issues and the introduction of topic related e-mail contacts for faster communication with market participants.
- Continue cooperating with European Commission's SRSS in strengthening **HANFA's supervisory capacities**.
- Continue carrying out activities related to financial literacy which should include the education of retail investors.

Cultural

- Initiatives to improve **financial literacy** of companies and retail investors. HANFA and HNB plan to continue with educational activities which include further cooperation with high schools and universities. Among other activities, HANFA used web advertisements to warn and educate retail investors about investing in highly risky complex products such as CFDs and binary options. It plans to use educational films/cartoons to reach users of financial services including retail investors.
- Support to SMEs that intend to list on the ZSE's SMEs Growth Market through specialized advisors whose role will also be to educate other SMEs interested in getting listed in the future.

3.5 Latvia

Based on contributions received from the Ministry of Finance and EBRD.

a) Challenges and impediments to capital markets development

Structural

- Latvian total **stock market capitalization** reached 4% of GDP in 2013¹⁸, which was the lowest rate among the EU member states (comparatively in neighbouring countries: Lithuania, in 2013 this indicator was 8%, in Estonia 10%¹⁹), suggesting that in the Baltics the development of the Latvian securities market is weak.
- Relatively small market size results in **high costs for entering the stock exchange**, due to the limited availability of qualified consultancy for preparation of documentation, as well as related service costs are perceived as high (for example, a stock issuance of EUR 15 million costs approximately EUR 300 000).
- Non-availability of **anchor investors**, due to the fact that the composition, small size and valuation of individual investments translate into high administrative costs.
- **Venture capital** market is not sufficiently developed and is not attractive to investors. Institutional investors lack the incentive to invest in local venture capital funds, and venture capital funds have a tendency to migrate to later stage investment in their growth phase. The total amount for which the market does not cover the demand for venture capital is estimated at about EUR 294-538 million.
- Access to **business angels** is limited due to lack of unifying networks and because of lack of experience. In the regional business incubators, new companies that would be attractive to business angels are rarely created, corporate presentation quality often is lower than expected by business angels, and opportunities to maintain the investment are limited. The total amount for which the market does not cover the demand for business angel sector is estimated at around 20 million euro²⁰.

Regulatory

Implementation of EU regulation

- Lack of online trading platforms for retail investors is partially due to the MiFID II increased organisational requirements on investment firms engaged in algorithmic trading and requirements for investment firms offering Direct Market Access. The MiFID II requirements on governance, prevention of market abuse, real time monitoring, pre- and post-controls, automated surveillance systems must be implemented by investment firms offering Direct Market Access even if the trading amount in these platforms is on very small scale. Those MiFID II requirements are also applicable to investment firms offering internet banking-alike solutions;
- In 2016, the European Securities and Markets Authority (ESMA) evaluated positively the idea of using **Inline XBRL as a single electronic format (ESEF) for financial statements** filings in Europe. EU's amended Transparency Directive mandates all listed companies to prepare their annual consolidated financial reports in Inline XBRL from 1 January 2020. It means another expense and administrative burden for listed companies, especially SMEs.

National rules and taxation

- Existing **tax procedure**, which requires monthly reporting to the State Revenue Service, which is bothersome for private individuals and not efficient also for the government since the amount of taxes is rather low. Therefore there is a need to launch a special procedure targeted towards private investors in order to decrease administrative burden.

¹⁸ Banking and Finance, Capital Markets in the EU, Capital Markets Factsheet, 30.09.2015, European Commission, Page 2.

¹⁹ Banking and Finance, Capital Markets in the EU, Capital Markets Factsheet, 30.09.2015, European Commission, Page 1.

²⁰ Ibid.

Supervisory

- The national securities market authority limits the **issuance and listing of bonds by non-banking lenders** on the regulated market to one. The limitation is based on the argument that borrowing from and lending to the public is an activity performed by banks. In order to provide such a service and issue public instruments, these firms have to obtain a banking license.

Cultural

- Limited knowledge and experience in investment activities lead most people to **saving in bank deposits** instead of investing their capital into the real economy. Bank deposits account for EUR 21 billion.

b) Potential solutions and areas for improvement: at national and cross-border level

The low securities market capitalization implies market-based equity instrument shortages (a market failure). Thus, there is a need to develop the Latvian capital market, at least by the amount of this market gap that according to the Ministry of Economics' assessment equals to 568 million euro²¹. It would require increasing the number of companies using equity funding, expanding the range of investment instruments and promoting a more active involvement of investors in the securities markets. In view of the above, the government defined three **strategic directions of action** in the capital market:

1. Increase the number of companies using capital market funding, including SOE's;
2. Develop capital instruments to increase opportunities for saving and investment;
3. Increase activity of institutional and private investors in the domestic capital market.

Structural

- Create a long-term (at least 3-5 years) **national support programs that promote and expand access to finance for SMEs** through support for equity and / or debt securities issuance, using national or EU funds. The support program should fully or partially cover the costs related to:
 - organization of offering (issuance consultants, emission drafting documents, legal advice);
 - attraction of investors (issuance agent, marketing activities organization);
 - shares and / or debt issuance record keeping of the original registry services, servicing of securities events and a list of shareholders / debt holders receive a list of JSC "Latvian Central Depository";
 - inclusion fee, an annual fee on the regulated and alternative market, as well as consultancy fees in the alternative market (stock exchange payments certified consultant).
- Develop and explain to the public a clear **National capital markets development strategy and plan for partial listing of state owned assets on local stock exchange. As the secondary effect thus increase holding of listed shares by pension funds, thus creating opportunities for more investment for pension funds in regulated market.** Create with experts a list of state-owned assets, to identify potential companies covered by the strategy and plan. Within the strategy, all investment in the state-owned enterprises should be provided by international initial public offering (IPO), targeting a broad circle of investors and offering 10-15% of the sale to pension and investment funds, individuals and other investors. In addition to raising equity capital, use public bond issuance in financing SOE's. That allows retention of ownership while obtaining funding on the basis of the company's defined conditions. Assess the possibility of completing the privatization through the public offering for companies such as Lattelecom and LMT.

²¹ Ministry of Economics. Market Gap Assessment, 2014, Page 132-140.

- A **strategic approach** should be adopted which would imply that when there is necessity to raise financing for enterprises with majority of government ownership, for government supported or municipality projects, it would have to be carried out by issuing and listing financial instruments instead of bank loans. As a minimum condition, an evaluation of alternative scenarios for attraction of financing would have to be conducted, where one of the options would be attraction of capital by issuance of shares or bonds.
- **Public support for establishing venture capital funds** is important (operating as alternative investment funds). Starting with the EU Structural Fund programming period for 2014 to 2020, public funds will be available for investment in equity for business angel co-financing, accelerators and quasi-equity instrument which provides mezzanine financing.
- Develop **instruments for enhancing the investment opportunities for Latvian 2nd Pillar pension funds**. 2nd Pillar pension funds have collected significant amount of resources, amounting to approximately EUR 3 billion and since pension system is relatively new in Latvia with very limited pay-outs, the total amount of funds have increased quite significantly.
- Develop **green bonds** for companies to invest in projects related to renewable energy sources, improving energy efficiency, environmental sustainability and climate change risks. These bonds increase significantly every year. Also in Latvia, Joint Stock Company “Latvenergo” have issued green bonds in 2015 and 2016, in total of EUR 100 million. JSC “Latvenergo” with green bond issue was one of the first in the new EU member states and enjoyed investors’ interest and low yield.
- Create support tools for the **management buy-out finance**.
- Pursue legal and regulatory reform to enable the enforceability of **close out netting**.

Regulatory

Implementation of EU regulation

- Prepare proposals for **administrative burden reduction** in the market listed companies, including the preparation of the prospectus requirements of small and medium-sized enterprises when launching the stock exchange quotations, also taking into account the Prospectus Directive review.

National rules and taxation

- Review the regulations for **asset backed securities and covered bonds**. Assess if it is up to date and corresponding to securities market development potential, concentrating on Baltic regional solutions.
- Improve the regulatory framework in order to remove existing obstacles to the development of **securitization**. Support creation of securitization vehicles. Although Latvian banks are not forced to look for new ways of lending, securitisation can create a new impetus for further use of loans through structured capital market instruments.
- Assess the possibilities for a **review of the state funded pension regulations** in order to encourage investment in the capital market, including the review of pension fund investment limits, the plan change frequency, manager fees.
- For the purposes of tax calculation and collection, it is needed to introduce "**an investment account**" for individuals, which would allow to invest more actively and to facilitate investment-related tax administration to individuals. The Swedish model of an Investment Savings Account (ISK) has proven very successful and in the first few years 2 million accounts were opened. The ISK allows the account holder to buy and sell shares actively without being taxed by every transaction. Instead a holding tax is calculated and collected. This provides a much less complex regime for the account holder and encourages investor activity. Within the national tax reform there is an initiative for optimising the individual income tax collection, therefore possibilities for introduction of investment account are feasible.
- Eliminate the existing barriers in regulations to introduce the **electronic voting system**.

Supervisory

[...]

Cultural

- Promote the availability of **information on the possibilities to raise funds on the capital market.**
- Review the **educational program** by providing more comprehensive amount of information on the capital markets, the importance and benefits of investors and listed companies.

3.6 Lithuania

Based on contributions received from the Ministry of Finance and EBRD.

a) Challenges and impediments to capital markets development

Structural

- The Lithuanian **capital market** is relatively small with low liquidity and highly concentrated ownership. At the end of 2016, the market capitalisation of Nasdaq Vilnius Stock Exchange was just about 10 % of GDP comparing to 30 % of GDP in pre-crisis period. The number of companies listed on NASDAQ Vilnius Stock Exchange decreases (28 companies in 2016 comparing to 33 in 2012). The Main List consists of 13 companies, the Secondary List consists of 14 issuers, and 1 company is listed on the Bond List. Nasdaq Baltic has one alternative market which operates as multilateral trading facility. At the moment there are two companies with listed equity on the alternative Nasdaq Vilnius First North market.
- The **debt markets** in Lithuania are dominated by Government securities with a Government Debt/GDP ratio of 40%. Current yields on 10yr government bonds are 0.75%. Even though the legal and institutional base has been fully developed in compliance with international and EU standards the commercial bond market is significantly underdeveloped. However, the greatest difficulty that Lithuanian companies are facing in accessing capital markets is their size and the small size of the Lithuanian market.
- The Lithuanian financial market is mainly dominated by **banks**. Their assets account for 79 % of financial system assets. The financing of companies through equity has been limited and bank lending remains the main source of corporate financing.
- **Institutional investments** in Lithuania could be increased. According to statistics, only 1/4 of Lithuanian pension funds' assets under management are invested in Lithuania and only around 1% of that amount is invested in equity markets. The biggest share of that investment goes to government bonds. Investments of investment funds and insurance companies are also not significant.

Regulatory

Implementation of EU regulation

[...]

National rules and taxation

[...]

Supervisory

[...]

Cultural

- The small market size in Lithuania is shaped by the **savings and investment culture of retail investors**. They usually choose simple and conservative ways of saving (bank deposits and cash) and are not interested in investment through capital markets.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- **Increasing activity of institutional and private investors** in the domestic capital market.

- Development of **local investment vehicles for institutional investors**
- **SME Listing Support Framework/ Instrument**

Regulatory

The Lithuanian Government considers the development of financial markets a priority. Efforts at both levels – national and EU – are important. In order to improve the efficiency of Lithuanian capital markets a number of changes of the regulatory environment have already been introduced since 2015.

Implementation of EU regulation

- **Crowdfunding.** A regime for crowdfunding and peer-to-peer lending was created. The Law on Crowdfunding came into force in December 2016. It sets the rules of investment-based and lending-based crowdfunding for business purposes. Rules on P2P lending for consumer credit are envisaged in the Law on Consumer Credit (amendments came into force in February 2016). The Law on Mortgage Credit introduces a possibility to finance mortgage credits through P2P platforms (those rules will come into force on 1st of July, 2017). This new Law on Crowdfunding created clear rules and a level playing field for market participants operating in Lithuania. The EU crowdfunding market is growing rapidly. A number of EU countries have already created national frameworks for crowdfunding and others intend to bring legislation on the issue into force in a near future. The lack of harmonized EU rules, absence of passporting regime and the fragmentation in national regulatory regimes create opportunities for legal arbitrage and are seen as the main impediments for the development of cross-border operations. The Lithuanian Government would support the idea of harmonized approach of crowdfunding/ peer-to-peer regulations at EU level.
- **FinTech.** The Government has adopted an action plan for further development of FinTech industry in Lithuania. The planned measures include further developing a regulatory sandbox, approving comprehensive e-Residency laws, creating better conditions for remote financial and insurance services, opening the way for the use of Blockchain (decentralised digital ledger) technology in the public sector. Special attention should be paid to data protection, anti-money laundering, fight against terrorism financing and consumer protection. However, the regulatory framework relevant to FinTech at EU level is fragmented, especially regarding the regulatory sandboxes. Although there are clear regulations of payment institutions and electronic money institutions across the EU, emerging FinTech business models require further regulation at EU level. In this light, the Commission's recent action – public consultation on FinTech to seek views on new technologies' impact on the European financial services sector, both from the perspective of providers of financial services and consumers, and whether the regulatory and supervisory framework fosters technological innovation in line with its three core principles (technological neutrality, proportionality, and market integrity) is welcome.

National rules and taxation

- **Corporate bonds.** In 2016, Lithuania approved legal acts facilitating the issuance of corporate bonds (by ensuring higher level of protection of bondholders' interests), and adopted amendments to the Law on Companies that made it easier for private companies to offer their bonds publicly. Further improvements to the legal framework that will establish criteria for private placement, provide for an opportunity to reward employees with shares and make legal form of partnership more suitable for venture capital are under consideration in the Parliament.
- **Financial instruments.** There is a need to take actions in creating effective financial instruments for institutional investors to be able to invest into the projects in Lithuania. The work has been initiated in several areas:
 - a project on **securitisation and covered bonds** is being implemented with the EBRD with the purpose to create an attractive legal environment, considering potential Baltic regional solutions;
 - in 2016, INVEGA (Investment and business guarantees Ltd) and EBRD signed a cooperation agreement that would help Lithuania implement risk capital instruments to

develop its **private equity and venture capital markets**. The financing programme will be used to implement four risk capital funds via selected financial intermediaries, deploying around €58.8 million of public funding and leveraging additional financial resources.

- In April 2017, Lithuania initiated a project with the European Commission (SRSS) on creating new financial instruments and a favourable environment for **institutional investors**.
- Last, but not least, actions have been taken to revise the regulatory framework for **investment funds**.

Supervisory

[...]

Cultural

- Lithuania gives much attention to increasing **financial literacy of consumers** so that they would be able to make rational financial decisions and manage their personal finance in a responsible way. In this regard, the Government adopted a plan for 2017-2020 which comprises a number of national financial literacy initiatives. Among them are measures for increasing financial literacy of schoolchildren and adults as well as programs for tax literacy.

3.7 Hungary

Based on contributions received from the Ministry of Finance together with the Hungarian Central Bank, Erste Bank Hungary, EBRD and AFME.

a) Challenges and impediments to capital markets development

Structural

- The capital market in Hungary is **quite well developed** but lacks liquidity and IPOs. A few listed companies dominate the equity market. The GDP capitalization of listed companies is among the lowest in Europe and there was no significant IPO in the last 5 years. Bank financing is cheaper and easier to obtain for companies than financing in the form of bonds or other similar capital market instruments.
- Overall, the relatively **high cost of an IPO** has proved to be a major obstacle for firms to get listed so far. There is strong foreign investors' dominance, and although their number has decreased recently, they still have a dominant position (in terms of ownership and trading volume) on the Budapest Stock Exchange (BSE).
- Local **retail investors only have limited presence on BSE**, due to their traditionally conservative investment behaviour. Speculative retail investments are mainly channelled through online platforms, focusing in particular on FX related products.
- In addition, a **continuous shrinking of the market** has been observed since direct dealing in the Hungarian stock exchange became a business with decreasing margins. Many service providers turn to higher yield business lines such as wealth management and/or private banking. Furthermore, some foreign services providers appeared in the Direct market access segment and are not subject to the sectorial taxes imposed by the Hungarian government which gives them a competitive advantage.
- The **post-trading environment** within the CEE region, including in Hungary, is still fragmented and currently no efficient cross-border clearing and settlement solution is offered, even though the Hungarian infrastructure service provider Keler Group (the Hungarian CSD – Keler Central Depository Ltd. and Clearing House Keler CCP Ltd.) has an ambition to offer these services to other countries. In a wider outlook, in the CESEE region there is lack of post-trading service providers in the field of central clearing which is due to the smaller market size. This should encourage the collaboration with already well-operating and experienced clearing service providers.

Regulatory

- The new **Markets in Financial Instruments Directive**, which will affect the whole of the European capital markets, will have a considerable impact on the operations of the investment firms and stock exchanges. The MiFID2 package, including Level 2 legislation, will put effective burden particularly on smaller investment firms, given that large firms are better equipped to address such regulatory challenges. Indeed, while essentially the new regulation appears to be designed to impose rules on the large market players, it creates a disproportional administrative burden for the smaller ones.
- Furthermore, the EU legislation adoption and implementation process does not always give enough time and opportunity for the market participants to review draft texts and discuss the expected impact of the changes. This is often due to the strict timeline determined by the nature of the EU legislation processes. This creates **regulatory instability** and the need of ex post modifications or explanations.

Supervisory

[...]

Cultural

- Going public or issuing bonds are not part of the typical corporate culture in Hungary. Traditionally, there is a **low level of financing of firms through capital markets**, and there is lack of confidence in the stock market, in particular among retail investors. By making an IPO less costly and burdensome, financing through capital markets should become an acceptable and available alternative to bank credit for Hungarian enterprises.
- As for retail investors, **lack of advanced investment education** is also a big obstacle to their greater participation in capital markets.
- The **scandal around the two Hungarian brokerage firms** resulted in both some positive and negative effects. It led to a general decrease in confidence towards investment service providers, but at the same time the market has been cleaned and became more prudent and integrated as National Bank of Hungary increased the level of its vigilance.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- The National Bank of Hungary and the Budapest Stock Exchange allocate reasonable **effort and resources to develop the Hungarian capital market** and to financially educate the already existing and potential retail investors.
- The overarching aim of the five-year strategy devised by the BSE for the period 2016-2020 is to formulate and implement a **comprehensive stock exchange development programme** in Hungary, which will result in the increasing role of the capital market fundraising in Hungarian corporate finance, making it an effective complement to bank credit. The objective of the BSE is to become the most important platform for competitive and successful enterprises in Hungary.
- **Attracting larger corporations and SMEs** which may represent a good investment opportunity, and assessing their stock market viability, is another essential BSE objective aiming to bring a diverse issuer structure and a higher stock market turnover.
- To meet the special funding needs of SMEs and increase their presence on the capital market, it will be necessary to **establish a new SMEs' market**. A dedicated multilateral trading facility (MTF) could play this role for smaller companies which are ready to operate in the public sphere but for which the requirements of the regulated market are too heavy.
- The improvement of existing **CSD links with EU-based CSDs** to support cross-border trading, clearing and settlement would be very useful. This would result in more efficient and cost effective solutions for the market players. For instance, Keler CSD has already started building new regional links with already existing CSDs in the EU. In the field of clearing, establishment of a regional CCP in CESEE region could also bring efficient and safe solutions for the market participants.

Regulatory

- The legal framework of the Hungarian capital market is increasingly determined by the international regulatory environment, in particular the new EU capital markets directive (MiFID2), and the associated regulation, notably MiFIR, which Member States will have to implement by 2018. The MiFID2 package (including level 2 rules) is very far-reaching and burdensome and therefore **lower regulatory requirements at EU level would be desirable, in particular for small investment firms**.

Supervisory

[...]

Cultural

- The Budapest Stock Exchange designs **wide-ranging educational programmes**, organises institutional roadshows as well as national and international capital market conferences, maintains active contact with domestic and international investors, and strives to exert an influence over both corporate leaders and investors through media presence. The BSE is focusing to identify and select

enterprises that require external funding, introducing the different forms of financing to them and preparing them for the capital raising process (e.g. ELITE programme with London Stock Exchange).

- The Ministry for National Economy of Hungary is developing a **National Strategy for financial education and financial literacy**, with a 7-year timeframe and based on the following principles:
 - existing fragmented programmes would be combined together to take advantage of synergies;
 - more efficient and targeted use of resources;
 - cooperation with the experts of: National Bank of Hungary, State Audit Office, Ministry of Human Capacities, Hungarian Central Statistical Office
- The key objectives of the **Strategy** are:
 - Strengthening the role of financial education in the school curriculum (obligatory financial education courses).
 - Increasing access to basic financial services (financial inclusion).
 - Encouraging the use of cashless payment services, reducing the relative weight of cash usage.
 - Improving financial behaviour (long-term financial goals, household budget) and financial stress tolerance (financial reserves).
 - Strengthening self-care approach.
 - Supporting prudent borrowing.
 - Supporting the development of financial infrastructure.

3.8 Former Yugoslav Republic of Macedonia

Based on contributions received from the Macedonian Securities Commission, Erste Group and EBRD.

a) Challenges and impediments to capital markets development

Structural

- The **financial sector of the Former Yugoslav Republic of Macedonia** (further in this section referred to as FYROM) is predominantly foreign-owned and bank based. **Banking sector assets** accounted for around 85.2% of the total assets of financial institutions in 2016, with pension funds and insurance companies having a share of 9.4% and respectively 3.5%. Other financial institutions had an almost insignificant share in the total assets of the financial sector in 2016.
- On the **primary capital market**, the government has an active role, through issuances of government bonds. The total **market capitalization** (listed shares on the official market, shares of joint stock companies with special reporting obligations and bonds) was (around EUR 1.95 billion) in 2016, an increase of roughly 12% compared to 2015 (21.0% of GDP, up from 19.6% of GDP in 2015). The total turnover on the Macedonian Stock Exchange in 2016 was around EUR 49 million, by 13.64% higher than in 2015.
- The FYROM primary market has a very low volume, number of issuers and issuance of securities. Over the last couple of years, most issuances have been through **private placements**. The number of entities from the corporate sector issuing securities has been lower than those from the financial sector. The bulk of issuances of securities have been shares with only a few bond issuances. The regional connection through the **SEE Link platform** on which the Macedonian, Croatian, Bulgarian, Serbian and Slovenian Stock Exchanges as well as the Banja Luka and Sarajevo Stock Exchange are participating, is expected to have long-term positive effects on liquidity and trading volumes.
- **Investment opportunities** on the FYROM capital market are very limited, as opposed to the need of investors for diversification. **Regulatory changes** were made to introduce new instruments, for example, **covered bonds**. However, despite of the interest expressed by some parties, no covered bonds have been issued so far.
- Companies are using the **traditional sources of financing**, barely the capital market. Companies prefer to finance themselves through bank loans. The regulatory costs and fees for **IPOs** were recently reduced, supporting projects for raising the awareness for IPOs were implemented, but these opportunities were not used by companies.
- The participation of **retail investors** on the FYROM capital market is also very limited. **Equity investments** represented only 8% of the total financial assets of households in 2016. Households remain the most important creditor of the banking sector and are still conservative regarding investments on capital markets, despite the low interest rates on deposits in recent years.

Regulatory

- In the context of the **regional integration of capital markets** (SEE Link), there are regulatory barriers for the securities depository for participation in international cooperation with other depositories and institutions, and regulatory barriers for settlement of cross-border transactions (in the regulations related to securities and foreign exchange operations). Currently, there is no possibility for the depository to participate in such activities, and the provided services are limited to participants on the local market.
- The **regulatory provisions for private funds** are insufficient. These funds are currently regulated by the Law on investment funds. However, this law does not include specific provisions on the authorization and supervision of these private funds or on regular reporting requirements to the FYROM competent authority.
- There is no specific **regulation for venture capital and business angels**, although there are initiatives for the adoption of such regulation.

Supervisory

- The **control of compliance** of market participants with the regulatory framework by the capital market supervisor seems to be less developed as compared to the intensive work done by the supervisor on technical aspects.

Cultural

- FYROM is among the European countries, which still have to develop an **investment culture**. Households tend to place their savings predominately in bank deposits and their interest in capital markets and more complex financial products is low. Currently, only a small part of the population is familiar with capital markets and its trust in capital markets has diminished during the financial crisis.
- **Insufficient transparency** by companies and the lack of inclusion of small shareholders in decision-making processes in companies are also among the factors which limit the appetite for accessing capital markets.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- To better serve companies and investors, measures for the improvement and modernization of market infrastructure should be taken on a continuous basis. **Market access** could be facilitated with further investment in digitalization (for example access through mobile applications). The modernization of the **clearing and settlement system** is also necessary to cope with the needs of cross-border trading. Improvement of **market data and data dissemination**, the introduction of **corporate action processing system**, the introduction of new technologies, improvement of the connectivity and interoperability between all market participants and especially with the securities depository should be done to increase the efficiency and attractiveness of the market.
- Establishment of a **special centre for investment research and analyses** supported by funds from international institutions. The research results would be shared with brokerage houses, stock exchange, regulator, investors and other stakeholders.
- Support for the **market participants** (trainings for employees, funds for developing IT Solutions, etc.) in meeting the new regulatory requirements to increase market efficiency and the confidence of investors in the capital market.
- **SEE link** as a project that created a regional infrastructure for securities trading should be further developed. Measures can be taken to ensure a potential geographic expansion to other countries in the region, to introduce new technologies, to provide investment research and analyses for the companies from the regional market and other market data. For the functioning of this project, the harmonization of the regulation at regional level (especially in the field of transparency and listing) will be necessary.

Regulatory

- At **cross-border level**, the harmonization and coherence between the **regulatory regimes** within the EU (the participants in the Capital Markets Union) is a priority. At the same time, there is a real need for a regulatory framework which is proportional to the size and complexity of different markets. The excessive regulatory requirements are detrimental for the small capital markets and its participants.
- The **new regulation on the FYROM capital market** harmonized with the EU-acquis is expected to be adopted in 2018. The by-laws for implementation of the new regulation should also be harmonized with the relevant EU regulation. A continuous support from the EU funds will be of a great use.
- Adoption of a **regulation for venture capital and business angels**. On the supply side, a positive impact could have the introduction of lesser regulatory requirements for SMEs and the adoption of regulations for bond issuances and for equity based crowd funding.

- Amendments to the **Law on investment funds** for introduction of ETF products to increase the pool of securities on the market.
- Regulatory measures and revision of the **investment limits for pension funds** in order to increase their activity on the equity market.
- Harmonization of the Law on **investment funds** with the AIFM Directive to strengthen the regulation and supervision of private funds and enable higher investor protection.
- Improvement of the regulatory framework to enable the **securities depository** to be involved in different types of international cooperation and to provide services according to the needs of the local, regional and international market participants.
- Review of **company law**: new solutions should be introduced and the revision of the existing one should be done to provide a proportionate regulatory regime to the size of joint stock companies, concerning their free float, listing regime etc. and to stimulate them to operate as a joint stock company. Improvements could be done in the area of related party transactions, treasury shares, internal audit, pre-emptive rights, employment ownership schemes, squeeze out rights, distinctions between private and public companies etc..
- Resolve the problem of **dormant accounts** in a way that would activate retail investment holdings and improve secondary market liquidity.
- Granting of tax incentives for long term investments on the capital market and increasing investment opportunities.

Supervisory

- To respond to the new regulatory environment and the needs of investors and companies, further measures should be taken to strengthen **supervisory capacity**. In this respect, support from the TAIEX Programme in the area of the technical solutions for supervision of market participants in accordance to new regulations will be very valuable. The intensified cooperation with the supervisory bodies of the EU Member States and from the region could improve the performance of the **enforcement and supervision function of the regulator**.
- Adoption of a **strategy for the FYROM capital market**. Support from the European Commission or other relevant institutions (EBRD, World Bank, etc.) would be of a great help for preparing the strategy as well as for the preparation of a plan of activities and measures for the implementation of the strategy.

Cultural

- **Investor education** measures are needed to safeguard consumers' investments and ensure that investors have all necessary information to make an informed investment decision. Programmes should be implemented at national and cross-border level for improvement of the **financial literacy** of investors, in particular of retail investors. Financial literacy could be enhanced through the organization of trainings, roadshows, preparation of manuals, brochures etc.

3.9 Poland

Based on contributions received from the Ministry of Finance, KDPW S.A. (The Central Securities Depository of Poland) and EBRD.

a) Challenges and impediments to capital markets development

Structural

The main structural problems of the Polish capital market indicated by participants of this market are:

- The relatively **small size of the market** – capitalization as of the end of 2016: EUR 267 billion, turnover for 2016: EUR 48 billion.
- The relatively **small size of the listed companies**. The average capitalization on the stock exchange's main market: EUR 548 million (EUR 307 million in case of Polish companies) and on the NewConnect market: EUR 6 million.
- Low free float in case of majority of listed companies, resulting in very **low turnover** (average annual turnover of company listed on the main market: EUR 99 million and on the NewConnect market: EUR 0.8 million).
- Lack of incentives to **individual savings** based on more advanced financial products.
- Lack of incentives for employers to create **pension plans**.
- Lack of a joint **capital market strategy** worked out by market participants, which would create a long-term action plan and address key needs in terms of institutional and regulatory changes.
- Relatively low competitiveness of **investment services** and low investment firms' innovativeness combined with relatively high management fees.

Regulatory

Implementation of EU regulation

- High volume and complexity of new rules and constant modification of milestone regulations, which creates instability. Both factors taken together are referred to as a „**regulatory overload**”.
- Excessive regulatory burden resulting from **maximising level of harmonisation** despite significant differences in the size of EU markets.
- Lack of **proportionality** in drafting new EU legislation. Regulations and standards established by European regulators treat Western European and CEE countries equally, based too often on the “one size fits all”, and do not take into account different levels of capital market development. For example, penalties for not (properly) disclosing insider information are set at the level of EUR 2.5m for legal entities by a Union-wide regulatory decision. These penalties are also enforced on the New Connect (SME) market. As of March 2017, the average market capitalization of New Connect companies was EUR 1.2m. Thus, such penalties exceed the market value of many GPW listed firms; these entities could potentially shut down after a single offence of delaying or not recognizing the significance of the insider information's potential effect on the company's share price. It is recognized as a major obstacle for SMEs considering potential IPOs in Poland. Listed companies quote this reason while considering delisting from the stock exchange.
- The **practice of narrowing interpretation**. The practice of narrowing the interpretation of EU legislation at the level of guidelines (Q&A) by the European market regulator (ESMA) bring solutions that differ significantly from the business practices of the CEE markets, forcing high adaptation costs. Example: ESMA Q&A4 to CSDR: Article 35 of CSDR expressly requires that CSDs use “international open communication procedures and standards with participants and market infrastructures” and allows for no flexibility, therefore internal or domestic messaging standards would not fulfil this requirement, even with a mapping from domestic standards to international open communication procedures and standards such as the SWIFT/ISO standards. The above strict interpretation may lead to an even greater deterioration in the financial situation of Polish brokerage houses, which usually do not have SWIFT infrastructure implemented. Moreover, this interpretation may pose additional operational risks for local market participants in their communication with KDPW (Polish CSD).

- **Limited access to knowledge** at the level of the “competent authority”. The regulatory detail may be significantly higher than at the level of national law. Knowledge that addresses issues regulated at level 2 and 3 is unique in the local market and is localized in the FMI (Financial Market Infrastructure) institutions rather than in the “competent authority”.
- **Inadequacy of regulatory solutions.** The common practice of copying (regulation levels 2 or 3) regulatory solutions applying to one type of FMI, to another type of FMI, without questioning the adequacy or applicability of the adopted solutions. Example: imposition of capital requirements for CSDs under RTS on prudential requirements (CSDR). CSDs, which have a low risk profile, and which do not provide banking-type of services or DvP links (FOP links instead), must hold funds in highly liquid securities as part of their recovery plans. The amount of these funds can be as high as 50% of total capital requirements. Such designed capital requirements reduce CSD's financial capability for further development.
- **Unrealistic timing of adaptation.** Interpretations, through guidelines of the European market regulator are published at the last stage of the regulatory process. As a result, key interpretations affecting the final model of the necessary implementations are made too late; this means that the appropriate adaptation to deadlines for applicable Level 1 or 2 regulations may not be possible or may involve extraordinary costs for urgent adjustment work; Example: ESMA Q & A 4 to CSDR.
- **Lack of elasticity** in the terms (deadlines) of adjustment. The Mandate for European Regulatory Framework (regulation levels 2 and 3) usually does not provide for a flexible approach to time limits for alignment with legislation. In practice, it is impossible to adjust the pace of adjustment to the specificity of the region.
- **High compliance costs.** Compliance costs may ultimately lead to the elimination of local FMIs - it is worth noting the niche nature of FMIs from smaller economies in the structure of the EU financial market. As a result of consolidation, forced by high compliance costs, Pan-European FMIs may not be entirely adapted to the specific needs of small-scale markets of the CEE region.
- **CSD links:**
 - According to Art. 40.2 of CSDR, a CSD, which does not provide banking-type ancillary services, may only offer to settle cash payments through accounts opened with a credit institution for the purpose of DvP links with another CSD.
 - Art. 54.5 of CSDR limits the ability to perform DvP settlement in commercial bank money (CoBM) up to a maximum of one per cent (1%) of the total value of all securities transactions against cash settled in the books of the CSD. If the settlement in CoBM, exceeds 1% of the threshold, a designated credit institution needs to be appointed (Art 54 2b. of CSDR). Until now, no such institution has been established and it seems that there is little chance of this happening in the coming years, due to restrictive regulations. Therefore, settlement in CoBM for CSDs, without banking-type ancillary services, is in fact, a barrier where the 1% threshold described above has been exceeded.
 - On the other hand, the process of establishing and maintaining DVP links is costly for small CSDs, among others, due to high regulatory requirements resulting in fixed costs, including the cost of conducting annual due diligence and monitoring of the risks associated with these links. This is true even in case of links to authorised CSDs in the EU, which are subject to strict supervision under CSDR. Limits on DvP settlement in CoBM within all links up to the aforementioned 1% threshold does not seem to be justified economically for small CSDs.
- **High fixed fees** charged by specific European institutions. Domestic entities in the CEE region that want to offer international services for their local clients are required to pay licensing fees to certain European institutions. Fixed fees are not adjusted to the local price level and significantly reduce the profitability of the services being introduced. This lowers the ability of local players to compete with their international counterparts on a larger scale. Example: EMMI (European Money Markets Institute) licence fees for benchmarks: Euribor and Eonia are necessary for clearing OTC derivatives in EUR at the local CCP.

National rules

- **Rising regulatory fixed costs for local brokerage houses.** Polish brokerage houses are usually key providers of services (IPO, analytical coverage, market making) for SMEs. Currently, more

than 800 SMEs are traded on the Warsaw Stock Exchange. From 2014, financial losses from basic brokerage activities are steadily increasing. One important factor affecting the poor financial situation of small brokerage houses is a systematic increase in fixed costs due to rising regulatory requirements (approximately 40% of cost growth in recent 3 years). The following factors have negative implications for SMEs listed on the Warsaw Stock Exchange:

- Downsizing of staff and dismissal of high-qualified professionals in small brokerage houses who advise SMEs on their decisions related to the IPO process.
- Decrease in analytical report coverage for SMEs. This translates into smaller turnover and lower liquidity.

Taxation

- Lack of **tax deductions for investors**, especially individual retail investors with a long-term investment strategy in equity and bonds of SME's or re-investing exchange generated profits. Individuals do not have the ability to deduct "capital losses" from their taxable income. Capital gains are taxed at 19%; however, if an individual generates a "capital loss", they cannot subtract the amount lost from their earnings.
- Not all investments are **taxed equally**. For example, "capital gains" on exchange traded instruments is the aggregate of gains and losses generated by investing in those instruments. On the other hand, if an individual invests in a Polish mutual fund or certificates of deposit, the "capital gains" from these investment vehicles are taxed immediately after withdrawing funds. This means the gains and losses generated in all investments are not combined into a one-sum "capital gain".
- Lack of **tax deductions for listed entities**. (An example of such an initiative could be the clarification and implementation of regulations pertaining to tax deductions of costs directly and indirectly associated with IPOs, as well as costs associated with listing financial instruments on the regulated market).
- Unfavorable debt market **tax solutions for individual investors**. Currently, investors are required to remit a tax payment based on the notional value of the coupon, regardless of how long they own the security. In practice, investors do not purchase bonds towards the end of the interest period because the interest tax is paid by the person receiving the interest payment from the issuer. Meanwhile, prices of bonds listed on the regulated market include interest based on time remaining in the interest period. This means for example that the seller of a bond in October, of which the issuer will pay out interest at the end of December, would receive interest accrued from January to October calculated into the transaction price, even though the issuer has not paid out the interest. The bond buyer will be paying out the interest through the adjusted purchase price. However, when the bond issuer pays out the interest payment in December, the new owner of the bond will have to pay taxes on the entire interest payment, even though he/she paid out the interest in the adjusted purchase price of the bond. An overhaul of the tax regulations would simplify and stimulate corporate debt secondary market trade, which in turn would increase capital available to SMEs.
- **Remittance of taxes in PLN** irrespective of the currency of payment. Current tax legislation requires withholding agents managing end-investor accounts or omnibus accounts that also act as intermediaries in processing cash distribution payments from the securities recorded on these accounts (dividends, interest payments) to remit taxes in PLN irrespective of the currency of payment. This takes place following the currency conversion of the income received via these intermediaries from cash distribution payments paid in foreign currencies to PLN according to the average foreign exchange rate published by the NBP (Article 12.2 of the CIT Act and Article 11a.1 of the PIT Act). Non-banks (such as KDPW) are not allowed to perform such foreign exchange at rates quoted by the NBP. As a consequence, withholding agents are forced to bear the cost of currency exchange differences due to the need to deduct tax in PLN from the payment made in foreign currencies by domestic issuers. This means that the costs of the tax processing are increased by foreign exchange differences, which are transferred to the issuer.
- Onerous **tax disclosure requirements for non-residents**. Foreign entities, which hold omnibus accounts in KDPW consider the process of submitting very detailed tax data as part of disclosure

of tax payers applying for full or partial tax relief from the standard rate, when processing corporate distribution payments by securities issuers, to be very onerous.

- Removal of the **requirement of registration agreements for foreign issuers**. Current provisions of the Polish securities law force all securities issuers to conclude agreements for the registration of their securities in the Polish CSD (Art. 5, subpara. 4). This practice is not seen on any other market for foreign issuers, whose securities were registered beforehand in their issuer CSD and which are dual-listed on the stock exchange. Foreign issuers may consider such a rule to be a barrier to the placement of securities on the Polish market.

Supervisory

- **Lengthy acceptance and authorization procedures** by the Financial Market Supervision Authority (KNF). Polish market participants often complain of the lengthy and often redundant document review process, especially regarding applications for new entities (investment firms, mutual funds) and prospectuses.
- Market participants also complain about a **strict interpretation of regulations** by the supervision authority without an appropriate consideration of the local market conditions, which is especially important in the case of EU regulations.
- Detailed process of approval of applications by the local regulator. The process of approval of applications related to **launching of new products** on the market (investment funds, ETFs, issuer's prospectuses) by the local market regulator is usually more detailed and thus more time-consuming than is commonly observed in mature markets. This in turn may lead to a negative impact for Polish market participants, due to rising competitiveness in Europe.

Cultural

- Lack of **basic knowledge of finance** and the underlying functioning of financial markets in the Polish society resulting in a lack of trust in financial institutions (perceiving exchanges, investment funds, banks or insurance companies as institutions acting to the detriment of clients).
- Lack of comprehensive **education program** concerning capital market.
- Limited **confidence in financial institutions**, related to relatively short and turbulent period of functioning of financial market in Poland.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- Working out the **capital market strategy** at the Ministry of Finance.
- Increasing the **size of the market**, which could be achieved by limiting regulatory burden.
- Considering the introduction of a **lower corporate income tax rate for listed companies** (CIT), which would offset the higher operating costs of these companies due to transparency and regulatory compliance. This would also stimulate the IPO market, especially for SMEs.
- Finding the means of **co-financing of analytical coverage for SMEs** listed on stock exchanges. One possibility to consider may be lowering taxes for listed SMEs (due to a high tax transparency of listed companies for Tax Offices) and to use these reductions to fund the preparation of analytical reports.

Regulatory

Implementation of EU regulation

- Introducing **appropriate regulatory regime for SMEs**, instead of forcing them to meet the same standards as global corporations. This could be achieved by creation of a regulation-free regime for small transactions (ex. IPOs and SPOs amounting to less than EUR 10M).
- Wider opening of the EU and national regulations to the **innovative solutions** (FinTech).

- Promote **collaborative practices** between competent authorities and FMIs. Promote working groups, workshops, etc. between local competent authorities and FMIs at the stage of legal interpretation and transfer of knowledge from and to the European regulator.
- **Flexibility of legal solutions.** Legal solutions that apply at higher regulation levels (Level 1 or 2) allowing for higher flexibility, lower level of regulation, implementation deadlines, including different rates of adoption in different regions of the EU.
- Applying the **principle of proportionality** when creating EU regulations and when implementing EU directives to local law. This also applies to differences in the level of sanctions that can be imposed on small local players, as opposed to large, internationally operating entities. Review regulations for domestic entities including investment firms in the CEE region. This applies in particular to entities operating locally, in terms of the ability to reduce and ease regulatory costs, depending on the size of entity/investment firms.
- Establish principles of **good practice for local market regulators.** This means harmonising the regulator's practices and setting maximum deadlines for approving applications for new products and authorising prospectuses in line with current market practice in most European markets.

National rules and taxation

- Removal of requirement of **registration agreements** for foreign issuers. Moving away from the necessity of concluding agreements between foreign issuers dual-listed on the Warsaw Stock Exchange and KDPW for the registration of securities, which have already been registered in the issuer's foreign CSD, with which KDPW has an existing link agreement. Rather than concluding agreements with such issuers, it is proposed instead that they be obliged to notify KDPW of their intention to commence the process of the registration of the securities they issue in the Polish CSD in connection with an application for the dual listing of those securities on the WSE. Such notification will enable KDPW to prepare accordingly for the registration of such securities.
- Payment of **taxes in the same currency** as the corporate distribution payment. This will enable withholding agents (i.e. tax remitters) managing end-investor accounts, or omnibus accounts and which act as intermediaries in the distribution of corporate payments from securities registered on those accounts (dividends, interest payments), to calculate, deduct and remit the withholding taxes in the same currency in which the original payment was paid out by the issuer.
- Reduction in the scope of **personal data from non-resident taxpayers.** Reduction in the scope of personal data required to identify a non-resident taxpayer in the tax form to the necessary minimum in connection with applications for tax exemption or payment of a lower tax rate than the standard rate when processing cash distributions paid by issuers of securities. Some of these details are redundant because they are already held by the Polish or Foreign Tax Offices.

Supervisory

- The most important solution for the Polish capital market from supervisory point of view raised by the participants of our capital market is introducing **market perception** among supervisory staff, which could be done by requiring market experience while recruiting supervisory staff and requiring secondments of present supervisory staff to regulated entities.

Cultural

- Increasing in the government's role in the process of **building long-term private savings.**
- Broader promotion of capital market and the introduction of **professional and ethical standards** in the area of educational and professional activities, to restore confidence in the market.
- Application of a **risk-based approach**, in particular allowing for development of unregulated business up to specified scale of operations.
- Allowing for more **responsibility of investors** (preceded by appropriate education programmes), to avoid increasing moral hazard.

3.10 Romania

Based on contributions received from Romanian Financial Supervisory Authority (ASF), Erste Group and EBRD

a) Challenges and impediments to capital markets development

Structural

- **Romania** has a predominately **bank-based financial sector**, with banking sector assets accounting for roughly 77% of the total financial sector assets at the end of 2016. The share of the financial system assets in GDP decreased slightly in 2016 (to roughly 74%), following the faster pace of economic growth relative to the changes in the total assets of financial institutions. The importance of **non-bank financial institutions, private pension funds and insurance companies** has grown in recent years. However, the non-bank institutional investor base is rather small and highly concentrated, with low levels of assets under management and limited participation in equity markets. At the end of 2016, private pension funds, insurance companies and investment funds held roughly 17% of total assets.
- The **market capitalization** of all listed companies on the main segment of the Bucharest Stock Exchange reached EUR 38.5 billion (23% of GDP) in May 2017 following the successful IPOs of Digi, a leading telecommunications company, and MedLife, the largest private healthcare services provider. Nevertheless, the **turnover ratio**, as a measure of market liquidity, remains around 7%, which is much lower than in Hungary or Poland. One of the main reasons for the low **secondary market liquidity** in Romania is the large number of small holdings in dormant accounts (i.e. inactive personal accounts as a result of the Mass Privatization Process in the 1990s). According to estimates, the **holdings of listed securities** in these accounts could constitute up to 30% of the theoretical free float of the Romanian market, acting therefore as an obstacle to increasing secondary market liquidity.
- The shareholders of the Bucharest Stock Exchange are mostly domestic small institutional investors without a common development strategy. Furthermore, ownership on the stock exchange is limited due to provisions in the national legislation to a 20% equity capital threshold.
- Although recent **IPOs** of Digi and MedLife proved that there is potentially strong equity demand driven by retail and pension fund investors, Romania's capital market is characterised by an under-developed base of buy to hold institutional investors and limited retail participation. Pillar II pension funds are the second largest investor group with asset under management of EUR 7.7 billion (as of May 2017). At portfolio level, Pillar II pension funds allocated 63.5% to government bonds and 20% in equity with 89% of the assets placed in local currency (RON) denominated instruments.
- Romania has also an underdeveloped **exchange traded derivatives market**, which reflects subdued equity market conditions.
- There is no licensed CCP currently, adding complexity to the potential development of an exchange traded derivatives market. The existing local CCP at the time EMIR entered into force did not manage to meet the new capital requirements, in the absence of a transitory regime or proportional requirements for smaller CCPs operating on less developed derivatives markets.
- The **government debt market operations** are comparable to that of developed countries. However, the **debt market** is in its infancy as it lacks liquidity and depth. In early 2017, the corporate bond market amounted to 1% of GDP compared to 3% in Poland. Moreover, Romania's corporate bond market is concentrated around the banking and the energy sector although several sub-investment grade local corporate issuers have tapped private placement markets in Europe. The **municipal bond market** is also very small.

Regulatory

- Disproportionate new EU regulations as compared to the current level of local market development in the country.

- **Cross-border taxes on capital gains** are complicated and time consuming.

Supervisory

- Limited **supervisory experience** of the Romanian Financial Supervisory Authority (ASF) in the context of a small and non-sophisticated market, history of a **compliance based model of supervision**, insufficient supervisory infrastructure.
- Despite concentrated market of intermediation with top 5/10 players from banking groups, small and medium investment firms are facing difficulties in coping with the **supervisory requirements**.

Cultural

- Low **financial literacy** and education of investors (risk aversion, lack of sufficient understanding of market risks, marketing of financial products similar to the one for deposits). Entrepreneurs are lacking financial education regarding financing opportunities on capital markets.
- Entrepreneurs lack of interest in **transparency regarding financial reporting**, expecting higher valuation of companies than decided by the market. They are also lacking equity culture and lack of interest in partnerships with other shareholders.
- Poor **market confidence** as a result of several failures in the investment funds industry or investment firms affecting retail investors. Retail investors have also been very risk adverse after the 2008-2009 capital market crash. Romania was one of the most impacted markets with a roughly 80% correction between 2007 and 2009 followed by a very slow recovery.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- **ASF STEAM project for reaching emerging market status**: several measures were already implemented, whereas other actions are still ongoing (for instance, the CCP solution for a Romanian exchange traded derivatives market). The remaining pending criteria for reaching the emergent market status at both MSCI and FTSE are related to market liquidity/free float, which is highly dependent on the quality of issuers traded on the market.
- Continue the positive trend for **private sector IPOs** (private IPO of EUR 207 million completed in May 2017 representing the largest private IPO ever in Romania). Furthermore, there are also prospects for new IPOs by state-owned enterprises on the Bucharest Stock Exchange.
- The **trading infrastructure** of the Bucharest Stock Exchange needs to be upgraded in order to increase its competitiveness, capacity to interconnect cross-border and respond to the technological developments.

Regulatory

- Review of the **markets and intermediaries' legislation** (transposition of MIFID II) may result in eliminating the threshold on the ownership in the Bucharest Stock Exchange. Legislation to enable a national solution for dormant accounts to reactivate and protect small investors while allowing for more efficient and active management of retail holdings including dividend reinvestment.
- Ensure stronger **guarantee funds and investors protection schemes**.
- Address legal bottlenecks with respect to the usage of collateral – particularly with regard to pillar II pension funds.

Supervisory

- Support from the SRSS on **asset managers and investment firms risk-based supervision** and possible new projects on other supervisory area.
- Internal ASF projects for strengthening **supervisory capacity**, including a data warehouse and other IT infrastructures.
- Continue bilateral cooperation to align to **best practices** in other more advanced supervisors in EU. Furthermore, use ESMA resources to strengthen **supervisory convergence**.
- Clear guidelines for market participants for **implementing legal provisions**.

Cultural

- Continue **investor education programs**. ASF is currently successfully organizing programs for youth financial education. For instance, ASF recently received an award (prize) of the Child and Youth Finance International. It is also important to continue the education of potential **bond issuers** through education roadshows/programmes provided by the Bucharest Stock Exchange, market regulator, arrangers.

3.11 Slovakia

Based on contributions received from the Ministry of Finance, Slovenska sporitelna (member of Erste Group) and EBRD.

a) Challenges and impediments to capital markets development

Structural

- The **Slovak capital market is one of the smallest** and probably most illiquid markets in Europe (i.e. low capitalisation, predominant bond trading). Equity market capitalisation remains well below its regional peers at 5.4% of GDP and few companies are listed on the stock exchange.
- The **main impediment** to the development of the market is connected to a combination of cultural and structural problems from the past. The lack of equity culture is a legacy of not very successful privatisation of the state enterprises in the 90's. As a result of these privatisations, 300 000 small “investors” hold worthless shares and are obliged to pay fees for the property account at depository. Therefore, in general Slovak citizens distrust the capital market. For them term deposits in banks provide a better alternative.
- The Bratislava stock exchange fully owns the **Central Securities Depository** of the Slovak Republic (CDCP), which is burdened with roughly 150 000 accounts, many of them dormant, (following the mentioned privatisation process). This overhang causes very high costs for the CSD and the majority of the staff is dealing with the administration related to dormant accounts.
- For firms seeking finance, the **negative interest rates environment** has encouraged them to choose cheap bank loans instead of capital market funding.
- On the other hand, **insufficient pool of institutional investors** is reflected by a very low number of company shares' transactions in the Slovak stock exchange. It is therefore crucial to maintain the present trade in government bonds in order to keep the stock exchange alive.
- **Bonds** are traded at the OTC market but are registered on the stock exchange by its members (obligatory membership for domestic traders). This creates an imbalance between domestic and foreign investors (non-members) for whom the costs are lower. The members of the stock exchange must pay extra fee to “compensate” for insufficient turnover of the stock exchange.
- Many branches and subsidiaries of **multinational companies are listed on the Slovak stock exchange** but they raise capital on the international capital markets which offer better conditions.
- Slovak companies are not interested to raise capital on domestic capital market. **Bank lending is cheaper and more accessible**, especially because of listing procedure and information requirements. In addition, financial intermediation lags behind in Slovakia compared with other CESEE countries.
- There is a very **limited number of potential new issuers** and in addition, the central depository fees for new issues registration are extremely high.
- Overall, the **Slovak capital market does not function efficiently** to match the supply of medium- and long-term assets with demand from investors. Bank financing prevails and international companies operating in Slovakia generally tend to use foreign capital markets. This is coupled with doubts of market participants about the privatisation agenda as well as the size of suitable assets available.

Regulatory

- Another impediment is the **excessive regulatory burden imposed by the EU legislation**. In recent years, many regulatory changes were made as a result of the financial crises in 2008 and 2011. The problem in the new regulation is clearly timing. In addition, changes in legislation do not sufficiently take into consideration local market conditions and do not give enough time to the earlier adopted legislation to be 'tested'. This creates uncertainty while banks complain about overregulation and extra costs, which will be passed over to costumers in the end.
- The demand for Slovak government bonds and T-bills remains fairly high but there is little to **no secondary market trading in government bonds**. As a measure to increase the attractiveness of

the government bond market, the government abolished in 2013 the withholding tax on investment income for most investors. The secondary market for corporate bond is also not liquid.

Supervisory

[...]

- Administrative procedures are very long and time consuming because **supervisory authorities lack capacity and resources**. There is also a lack of clear guidance from the Commission and/or ESMA, when it comes to the application of the EU legislation, which results in different interpretation of the EU legislation by national competent authorities.

Cultural

- Other weaknesses of the Slovak capital market are **distrust of retail investors** and of the general public, their relatively low disposable income and insufficient level of financial education.
- Furthermore, there is **no well-established culture of entrepreneurship**. Enterprises have no, or very low, appetite for risk-taking. SMEs finance their activity with bank loans while other sources of funding (equity, investment funds) are hardly used. Another issue is that very often SMEs have no appetite for growth, as soon as they reach certain level.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- According to the Slovak Ministry of Finance, there is a space for **closer cooperation between national stock exchanges** in the same geographical region (which would allow to compete with traditional big stock exchanges). Small stock exchanges suffer from insufficient number of investors and issuers. Another possible solution would be to establish one common CEE stock exchange with existing national trading floors as its subsidiaries.
- Slovakia is setting up a fund financed by the European Structural and Investment Funds (ESIF) that should provide **repayable funding to the market and SMEs through financial instruments**. Slovakia considers that the ESIF, together with the European Fund for Strategic Investment (EFSI), could play a very important role in the Member States, where the capital market is not developed. The national or supra-national fund financed by ESI Funds, EFSI or by EIB could help mobilize additional capital in Europe and channel it where it's needed, in particular SMEs. In this respect it is important that the rules for financial instruments in the ESI Funds and EFSI are very flexible and that they permit the use of these funds in line with the market practice.
- Another solution could be to ensure that **future sale of the state property is done through the stock exchange where applicable**. The government should also improve the enforcement of law, the efficiency of judiciary and the business climate.
- At cross-border level, in order to interconnect EU markets, **tax regimes across Europe should be approximated and simplified** as much as possible.
- Slovakia should **better cooperate with stock exchanges and CSDs in the region** to build connections and help local investors' access Slovak equities traded in international markets. It should also modernise infrastructure and the exchange/CSD systems and provide a solution to inactive accounts at the CSD.

Regulatory

- Regarding the recently introduced new EU legislation, **longer deadlines** for transposition and implementation should be proposed to give more time to market participants. Overall, frequent changes in legislation, for example in the second pension pillar, should be avoided. It is also necessary to find a balance between the regulatory requirements imposed on providers and consumer protection.
- The revision of regulation and directives aiming to **remove cross border barriers for the managers of alternative investments funds** should be considered. Further harmonization aiming

at the removal of the fees and the administrative burden for the managers and funds in the host Member States is also needed.

- Slovakia should **reduce the administrative and tax burden on new issues** of securities and trading on the capital market and develop new capital market instruments to meet the demand of retail and institutional investors.

Supervisory

- The setting up of **advisory services explaining the stock exchange** rules could be considered by the government.

Cultural

- **Investor education** programmes should be developed and supported by the state in order to restore trust towards the capital market.
- SMEs should be incentivised to **enhance their transparency and corporate governance**.

Based on contributions received from the Securities Market Agency and EBRD.

a) Challenges and impediments to capital markets development

Structural

- The **Slovenian capital market is relatively inactive** and requires more depth and liquidity. Financial intermediation relies mostly on the banking system with established lending relationships, while the development of the non-bank financial sector lags behind its EU peers.
- One of the key problems as regards the Slovenian capital market is the **small size of the market** and consecutively low number of daily transactions. Market capitalization of all financial instruments on Ljubljana Stock Exchange (LSE) in 2016 was 26,12 billion EUR (21,12 billion EUR market capitalization of bonds - of which vast majority are state bonds - and only 4,99 billion EUR market capitalization of shares) or 65,7 % of GDP, an increase of 8% compared to 2015. The volume of trading stopped at 0,33 billion EUR in 2016 (0,84% of GDP), while 94% of total volume represents trading in shares of public companies (still 35% of that with shares of single public company) and only 6% trading in bonds.
- On 20 July 2017 there are **only 44 companies listed on LSE** and this number still decreases due to growing number of mergers and acquisitions, and the decision of smaller companies to delist. In connection with the market structure it should also be pointed out that shares and bonds have predominantly been issued on the Slovenian capital market in the past. In 2016, the Securities Market Agency approved only two prospectuses for the public offering of securities. Furthermore in 2016 only three new financial instruments were accepted to trading on LSE while the total number of financial instruments accepted to LSE fell from 89 to 76.
- An important impediment for institutional investors to invest in shares of Slovenian public companies in the past has been relatively **high participation of the state** in these companies. In a substantial number of public companies, the government can still decide on the management of these firms which is why these companies are often not attractive to other investors. Although privatisation of state-owned enterprises started back in the 1994, this process is still on-going and has not been completed yet.
- All government bonds and T-bills issued for budget financing are listed on LSE but **most bonds are illiquid**. The size of commercial papers and bonds represents a small fraction of the exchange turnover.
- Retail investors are discouraged to invest in stocks by a **high level of tax imposed on capital gains**. Shares are subject to the tax at a rate between 25% and 0% based on a sliding scale which reduces the percentage of the tax for every 5 years of shareholding by 5%. It appears that frequent changes in taxation and the length of administrative processes with respect to tax compliance also negatively affect institutional investors.
- The number of brokerage companies and banks that provide **investment services and activities is constantly decreasing**. At the end of 2016 there were only 4 brokerage companies (as compared to 9 in 2011) and 11 banks offering investment services and activities (as compared to 16 in 2011).
- The net value of **assets of Mutual Funds (MF)** managed by local Management Companies (MC) at the end of 2016 stopped at 2,46 billion EUR (1.200 EUR per capita), that is 6,7% more than at the end of 2015 (increase of 155 mil EUR is a result of 15 mil EUR net in-payments and 140 mil EUR of growth in the value of assets). 60% is invested in MFs with principal investments in shares. Percentage of investment in securities of foreign issuers is growing (77,1% at the end of 2016), while investments in securities of home issuers dropped by 2% (to 6,5% at the end of 2016) probably due to lack of new offers of home issuers on LSE. Total number of investors in MF has been relatively stable for the past few years (around 420.000).
- As for **Mutual Pension Funds (MPF)**, there are three operators with 1.010 mil EUR assets under management on the last day of 2016 (4,8% increase compared to 2015 - a result of 14,4 mil EUR net in-payments and 31,7 mil EUR of growth in the value of assets). Investment in securities of home issuers was 26% of which 25% in bonds and only 1% in shares. The number of MPF

members increased by 2,6% to 266.300 members and the majority of them are included in MPS through their employers and less than 1% of members are included on an individual basis.

Regulatory

- The **high transparency reporting demands have proven to be burdensome** along with relatively fast changing national and European legislation for listed companies. In particular, this has had an adverse impact on smaller companies, many of which were listed during the privatisation process. They have limited resources and lack skills necessary to comply with complex and demanding legal requirements.
- More specifically, **lack of proportionality of the European legal framework** results in disproportionate and therefore excessive demands (along with consecutive higher costs) for smaller markets like Slovenia. This has evidently led to the lowering number of market participants and service providers able to follow and comply with always higher regulatory demands (let alone be able to stay competitive or profitable).

Supervisory

- Securities Market Agency has only 46 employees which poses a challenge given the number of supervisory responsibilities and market areas to be covered.

Cultural

- Households in Slovenia still prefer to keep their savings mainly in a form of **bank deposits**. Their interest in the capital market and other forms of financial investments is quite low, especially among less educated persons who do not sufficiently value the diversification of their savings. Predominantly conservative methods of saving despite extremely low interest rates on bank deposits in recent years can be also explained by lower disposable income in our region (CESEE) compared to other EU Member States. Given a general low level of savings, investors tend to be more risk averse when deciding upon their investment strategies.
- **Weak financial education** does not help retail investors recognise other investment opportunities. Better financial literacy could result in their greater openness towards investments in the capital market and in other financial products beyond bank deposits.
- Following the financial crisis and the **write-off of shares held by retail investors** in the process of restructuring of the banking sector, it has been observed that retail clients are still more reluctant to invest in stocks, although some positive trends and signs of slow recovery are back.
- Companies find **financing through capital markets too expensive**. Costs related to the capital market access and compliance costs are considered too high compared to potential benefits. Therefore they prefer (cheaper) debt financing through bank loans.

b) Potential solutions and areas for improvement: at national and cross-border level

Structural

- The **state should privatise most of its stake in public companies** as the privatisation process that started in 1994 is still not completed.
- It should come up with effective **governmental strategy** for the capital market development, including for instance: initiatives aiming to encourage non-public companies to get listed, assuring educational, legal, financial and other needed support for future IPO's.
- The state should **adjust the legal framework** and provide necessary incentives to attract savings to the II and III pension pillars. This would enable bigger flow of funds to the capital market and would allow pension funds to become stronger capital market investors.
- The capacity of the listed market should be deepened to provide financing, possibly through **linkages and/or cross-listing with other regional exchanges**.

Regulatory

- Since most of the Slovenian companies are SMEs, the proposed **changes aiming to simplify the prospectus regime are most welcome** (not only from the issuers viewpoint but also for investors

who can make their investment decisions based on the clearer information provided). As regards the administrative burden, the reduction of transparency requirements is also welcome.

- In addition, **legal certainty and clarity should be assured** (in terms of timing and interpretation) in order to guarantee adequate and stable legal framework for all participants in the capital market.
- The state should create a **better tax environment** for capital markets' profits (e.g. lower taxes and simpler and more flexible tax procedures).

Supervisory

- **Strengthening communication between supervisors and capital market participants** regarding upcoming changes and amendments of relevant regulation, along with organising more meetings where all relevant issues can be discussed.

Cultural

- **Financial literacy** of investors, in particular retail ones, should be improved using broad and diverse tools such as presentations, trainings, brochures etc. Investor education would ensure that they have knowledge and all the information to make an informed investment decision. Initiatives for improvement of financial literacy should also come from ministry and/or government level.

4. Policy conclusions

The participants of the Working Group shared various proposals for policy actions that can support development of capital markets in Central, Eastern and South Eastern Europe.

Most can be done at the national level and many countries have already taken various initiatives. Concrete examples were presented in the Group's discussions. They are also mentioned below, as the basis for the formulation of policies and as inspiration for all national governments. Country-specific details are included in Chapter 3.

Other proposals were made for action at the regional level. They were based on experiences with cross-border cooperation, for example by stock exchanges or international institutions. Some suggestions may be difficult to put in practice, due, for example, to conflicting interests or coordination challenges. They are presented to highlight the potential benefits from regional cooperation.

Finally, the Group pointed at issues at the EU level, affecting all capital market players in Europe. Participants indicated some challenges posed by EU regulation for smaller and less developed markets (in particular proportionality).

4.1 Priorities for policy action at the national level

1.1.1. National strategy and promotion

Several countries of the region have either recently adopted or are planning to come up with national capital market strategies. The strategies present policy directions and problems to be addressed in order to give a boost to the local capital market. They are usually agreed at governmental level and incorporate the views of public authorities (markets regulator, ministry of finance, etc.) and private actors (e.g. business and investors associations). Some of the strategies are developed with the assistance of the European Commission Structural Reform Support Service.

The following countries have already adopted a capital market strategy: Bulgaria, Hungary. Similar strategies are in preparation in Poland and Lithuania.

Capital markets strategies define priority actions. Depending on the needs of the local market, they can be of legislative, institutional or structural nature and are to be implemented within a certain time period. The strategies can also propose accompanying measures such as communication or educational actions, for instance to disseminate information about capital market opportunities in order to attract corporates and investors, or to educate them about different opportunities in these markets.

Overall, spelling out such strategies has a positive impact because they focus attention and bring national authorities and organisations together with the objective to develop capital market. It is important that actors involved demonstrate commitment in the timely introduction of reforms and measures proposed by the strategy.

4.1.2. Business environment

A friendly business environment is key to the development of capital markets. Such environment is formed by a number of elements which together facilitate and encourage the participation of companies and investors in capital markets. The most mentioned by countries in their survey responses are a stable legal and judiciary system and an efficient administration. In addition, insolvency and tax regimes are mentioned as critical in enabling capital market development.

The tax regime which applies to listed companies, including SMEs, plays an important role in the decision of companies to access capital markets. A favourable tax treatment, in the form of lower taxes (Corporate Income Tax) and easier tax procedures would incentivise companies to go public and would help maintain on the stock market those companies which are already listed. A favourable fiscal treatment could offset high costs which listed and to-be-listed companies have to incur in relation to

higher transparency and regulatory requirements. Where budgetary possible, tax advantages to investors in order to attract their savings to capital markets, are also to be considered.

An Investment Savings Account, as e.g. implemented in Sweden, is being considered by Latvia to attract investors. It allows the account holder to buy and sell shares actively without being taxed at every transaction. Instead, a holding tax is calculated and collected.

With respect to corporate actions, the Czech Republic proposed to adopt common standards for actions such as dividend and coupon payments, tax reclaims related to these payments, rights issues and tender offers. If the documents' requirements and conditions differ, for instance foreign and minority investors are at a disadvantage versus local investors.

4.1.3. Public support for companies to access capital market

Excessive costs for SMEs to prepare their IPO and comply with related legal requirements have been raised by several country responses to the questionnaire. These countries suggest using public funds – either from the state budget or EU structural funds – for targeted assistance to SMEs in their access and participation in the capital market. In this context, it is worth mentioning that projects under which SMEs can count on financial support for their IPO under different public schemes have been already implemented in some countries of the region.

For instance in Poland the "4 Stock: facilitating SMEs' access to capital markets" programme was implemented by the Polish Agency for Enterprise Development and the Warsaw Stock Exchange and it offers a reimbursement of 50% of the SMEs' costs related to the preparation of an IPO. The programme facilitated many SMEs' access to the NewConnect stock and Catalyst bond markets of the Warsaw Stock Exchange since 2011. Another public programme supporting enterprises' access to capital markets is carried out by the Budapest Stock Exchange (implemented together with London Stock Exchange) and it is called 'ELITE'. Under the programme, the BSE selects and offers different forms of financing to firms preparing their IPO.

More countries of the region already consider introducing, or are about to implement similar projects co-financed from public or EU funds. Among them, Latvia is coming up with a programme to promote and expand the access to finance for SMEs through the issue of securities. It is planned that the programme will co-finance the issue of equity or debt and will cover costs related to the IPO (consultancy, drafting of documents, legal advice, etc.). Latvia is also proposing to use public support for the creation of private equity and venture capital funds that would invest in local companies and help attract private investors.

Apart from the preparation of IPOs, there are other costs related to the participation of SMEs in capital markets where public support could be of help. For example, Poland points to the need of listed SMEs to be covered by costly analytical reports prepared by brokers, whose research concentrates on big companies in line with the need of institutional investors. According to Poland, reducing taxes for listed SMEs would be a way to compensate for the expenses which SMEs have to pay.

In relation to the high costs incurred by listed, or to-be-listed, SMEs', some countries have pointed to EU initiatives aiming at lowering these costs. In this context, the Czech Republic mentioned the new EU regulation on the prospectus adopted in 2017 which simplifies the rules and streamlines administrative procedures making it cheaper and simpler for small businesses to access capital markets. The country also referred to the CMU mid-term review which announces further actions to make the participation of SMEs in capital markets less costly.²²

²² However, the Prague Stock Exchange recommended keeping the same level of documentation for both standard and SME prospectus.

4.1.4. Privatisation

Privatisation of some state-owned companies through the local stock exchange would also give a boost to capital market development in CESEE countries. This would help meet the criteria necessary to raise the capital market status from Emerging to Developed according to the MSCI index (as mentioned by the Czech Republic).

Furthermore, companies with a majority public stake, including at municipal level, should give preference to raising funds through capital markets. Issuing both equity and bonds should be considered by public enterprises.

4.1.5. Institutional investors

Many respondents to the survey pointed to the need of expanding the institutional investors' base on local capital markets. Given the lack of opportunities, some investors such as pension funds, choose to invest abroad on more liquid and mature foreign stock markets.

Lithuania launched a project with the SRSS, aiming to create new financial instruments and a more favourable environment for institutional investors.

4.1.6. Financial education

Both investors and enterprises need to better understand capital markets in order to make greater use of them. Following the financial crisis, the confidence and trust of both groups in financial markets should be restored so that they can recognise their advantage as an alternative to traditional banking. This view has been shared by several responses to the questionnaire and many countries have already taken steps to improve financial literacy of investors and enterprises. For instance, Latvia, Lithuania, Hungary and Croatia have developed their national strategy for financial education. The Czech National Strategy for Financial Education published in 2010 is being revised.

Some countries (e.g. Slovakia) propose to launch an information campaign targeting the holders of dormant accounts created in the 90's when shares of state-owned companies were distributed to employees. The accounts' owners should be encouraged to re-activate their assets and informed about the options to dispose their shares in a financially effective way. In 2014, Slovakia developed a national strategy for financial education with the aim to educate population in all segments of the financial market.

4.1.7. Supervision

Adequate supervision is a key ingredient for building stable and trustworthy capital markets. Given limited resources, the available supervisory capacity and expertise does not always match the expansion of financial markets in the CESEE countries. Supervisors should be encouraged to recruit candidates with market experience and to arrange for temporary secondment of some of their staff in firms they oversee. An alternative could be to organize exchange programmes with firms abroad or other supervisors within the EU to avoid conflicts of interest with monitored market participants.

4.2 Potential for cross-border projects and cooperation

Cross-border cooperation has already started among capital markets of the region. There are three regional groupings of stock exchanges with more or less an advanced integration of services: the Nasdaq quasi-single Baltic Market, the CEESEG holding including Vienna and Prague, and the growing South-East Link platform (see also Chapter 2). The remaining stock exchanges (Warsaw, Budapest, Bucharest and Bratislava) are not part of any strategic alliance.

According to some participants, there is space for more cooperation between national stock exchanges in the region. Today, there are many small stock exchanges that suffer from an insufficient number of

investors and issuers. A way forward could be to expand the existing geographical alliances to non-allied markets and deepen their integration.

4.2.1 Foreign listing and market access

To broaden the scope of instruments available to local investors and to facilitate listing on other EU markets for local issuers, national stock exchanges can create new markets dedicated to foreign trading. It may attract new members to local stock exchanges by offering them direct access to liquid instruments in Europe and the rest of the world. It may help to overcome the hindrances resulting from the small market size.

The idea is based on a project by the Bulgarian Stock Exchange to establish opportunities for Bulgarian investors and issuers to access, via the Bulgarian Stock Exchange, foreign markets, including listing on such foreign markets. The project named BSE International is related to the creation of a new regulated market segment for instruments with EU-compliant prospectuses and establishing of a Multilateral Trading Facility for all other instruments (see Chapter 3).

4.2.2. Central Securities Depositories

As virtually every stock exchange has its central security depository (CSD), tasked with post-trade clearing and settlement of securities, cross-border cooperation of CSDs is important for supporting cross-border trading. It may take place in particular within the regional alliances of stock exchanges. The project of the SEE Link, supported by the EBRD, to facilitate the settlement procedures among the participating exchanges is an example here (see Chapter 3). The proposed solution includes settlement in the respective local CSD based on standardized instructions exchanged between an investment firm that has accounts in all regional CSDs, the SEE Link brokers and the CSDs.

Any stock exchange in the region would benefit from establishing links with CSDs in other, possibly larger capital markets in the EU. Such connections would support cross-border trading, clearing and settlement in general. In particular, they could help local investors' access local equities traded in international markets.

4.2.3. Central Clearing Counterparties

Some elements of market infrastructure, notably Central Clearing Counterparties for clearing and settlement of derivative transactions, are costly and complex to create. Given the nascent state of derivative trading in many CESEE markets, there is not a case for creating national CCPs in every country. The existing CCPs which already have the recognition of compliance with the EU standards (the EMIR Regulation) from the European Securities Markets Authority, i.e. Polish KDPW_CCP, Hungarian Keler and – possibly soon – Croatian SKDD-CCP Smart Clear, could develop their clearing services and offer them also on a cross-border basis to other stock exchanges in the region.

4.2.4 Creating regional markets by harmonisation of regulation

Some market segments that are not harmonised at the EU level could benefit from the establishment of a harmonised legal framework at the regional level. While European harmonisation may require complex negotiations and time, the coordination within clusters of national regulators may support development of specific market segments. The ongoing coordination of rules for covered bonds and securitisation in the Baltic countries, sponsored by the EBRD, provides an example. Its purpose is to create an attractive legal environment in the Baltic regional market.

4.3 Policy issues at EU level

EU capital markets' legislation has been designed to ensure a level playing field in the single market. Nevertheless, in some cases small markets, given their early stage of development, may encounter difficulties to apply this legislation. Also, implementation deadlines are sometimes tight for small players. This is the issue of proportionality where proponents call for exceptions. On the other hand, it

is important to find a balance in the regulatory requirements imposed on providers of financial services or investment products to avoid distortion of competition and to ensure protection of consumers (raised by Slovakia).

In this context, three issues deserve particular attention, namely: *(i)* proportionality in EU legislation which if not appropriately calibrated may act as a barrier for the development of CESEE markets, as well as the complex implementation of EU law for which technical assistance could be considered, *(ii)* support for the ongoing process of EU law harmonisation in certain domains of particular relevance for CESEE (e.g. some areas of FinTech) and *(iii)* the mobilisation of financial instruments by EIB, EBRD and World Bank for better capital market development in the region.

Whereas this report conveys the proposals made by the Working Group members, the European Commission will outline its official position on the identified issues in the forthcoming communication on EU support for local capital markets.

4.3.1. Proportionality and implementation of EU regulation

Legal requirements imposed on different actors, particular small firms, may be too costly and burdensome and therefore may discourage these firms to participate in an IPO. According to a great majority of SMEs in the CESEE, the costs and regulatory constraints of being listed outweigh potential benefits.

Particular attention should be paid to a “small jurisdiction” according to the state of development of national capital markets, irrespective of whether this Member State belongs to the CESEE region or not. Austria proposes to determine (e.g. based on advice from ESMA and EBA applying relevant technical criteria) if a national capital market is sufficiently developed or not to qualify for specific legal exemptions (i.e. preferential treatment or longer deadlines for the implementation of certain requirements).

A specific concern in this context is the issue of "MREL bonds" (Minimum Required Eligible Liabilities) to be issued in the near future by banks domiciled in CESEE. The current stage of capital markets might be a limiting factor for absorption of the MREL bonds. It may curb banks in their development, if they are not able to meet the minimum requirement for own funds and eligible liabilities (MREL). Moreover, there is the risk that the need to build up MREL eligible liabilities might lead to “cross-investment” within local banking sectors, of which regulatory acceptance needs to be verified. Austria welcomes that the European Commission’s legislative proposal for the review of the Capital Requirements Regulation (CRR) does not exclude the option of recognising as MREL the bail-inable bonds issued by the bank subsidiaries bought by the parent banks also under an MPE (Multiple Point of Entry resolution). This option could be helpful where a sufficient issuance of external MREL is not yet feasible due to the infant state of local bank bond markets, while all other conditions qualifying the subsidiary for an MPE strategy are fulfilled. In these circumstances and until local markets have sufficiently developed, parent banks could first purchase a certain portion of a subsidiary’s bond issue and then later sell these bonds step-by-step on the secondary market, thereby contributing to a smooth development of market liquidity. The issuance and marketability of these instruments and local capital market development could be further stimulated if IFIs, such as the EIB, EBRD and the World Bank Group/IFC expand their investments in such instruments.

Croatia pointed, among other issues, to excessive remuneration requirements imposed on small management companies which offer non-complex products (UCITS5 Directive), the high level of sanctions for small issuers (Transparency Directive), the generally high and (for small markets) prohibitive and disproportionate level of administrative sanctions in relation to income levels that may act as a barrier of entry and relatively large capital requirements as well as other costs for non-banking CSDs. Another issue pointed out by Croatia was the upcoming (proposed) changes to CCP supervision (under EMIR) and new requirements for CCPs foreseen by the new CCP Recovery & Resolution Proposal. The additional requirements may cause smaller local CCPs to go out of business, leaving smaller MS with no option, but to access larger infrastructures in other Member States. This, in turn,

will likely cause costs of clearing to go up substantially in smaller markets as well as exacerbate the already access problem for small financial counterparties relating to derivatives clearing. For CESEE cash markets, this could also prevent initiatives to offer clearing services on a cross-border basis to other stock exchanges in the region. Croatia also stated that certain prudential requirements from EU legislation are disproportionate for investment firms in smaller markets in relation to their size and complexity of their activities and services provided. In this context, Croatia suggested that, while the EU regulatory landscape must ensure a level playing field, there is room for targeted revisions of EU legislation.

In view of the Czech Republic, current legislation should be reviewed and introduce different levels of requirements and sanctions according to the size of investment firms and other entities operating in capital markets. Sanctions under MiFID2 were mentioned as too burdensome for small players. Hungary agreed that MiFID2 imposes excessive regulatory burden on small investment companies and that these rules should be better adapted to small capital markets to allow for their growth.

Poland drew attention to the penalties for not (properly) disclosing insider information set at EUR 2.5 million, which is considered too high for small firms operating on the New Connect market (an exchange for SMEs under the Warsaw Stock Exchange) compared to the average market capitalization of New Connect companies (EUR 1.2 million in March 2017). The level of penalties is considered as a major obstacle by SMEs which consider an IPO.

Finally, several institutions underlined that capital markets need a clear and stable legal framework to prosper. Czech Republic and Slovakia remarked that the EU legislative process is complex, with little time for market players to prepare. Technical assistance in the implementation of EU laws could be provided by the EU. It should have a very practical dimension (e.g. take the form of roadmaps and instructions) and should be tailored to specific needs of the countries concerned.

Slovakia suggested that financial market regulators and other responsible authorities should cooperate more closely with financial institutions (e.g. by means of working groups, workshops, etc.) for better legal clarity and to allow for the exchange of knowledge and experience between different actors.

4.3.2. Need for harmonisation at EU level

Several country responses supported the need for the ongoing further harmonization of certain regulations at EU level. For instance stakeholders from the Czech Republic mentioned corporate, insolvency and securities laws.

Lithuania pointed at the need to harmonise crowdfunding rules where a number of EU countries have already adopted relevant legal frameworks and others intend to come up with them in the near future. The lack of harmonized EU rules on crowdfunding, the absence of passporting regime for crowdfunding entities and the fragmentation in national regulatory regimes create the risk of legal arbitrage and are seen as the main impediment for the development of cross-border operations.

In the same vein, Lithuania and Czech Republic advised that FinTech solutions require a better legal alignment at EU level. The legislative framework relevant to FinTech is fragmented, especially regarding the regulatory sandboxes. Although there are clear rules for payment and electronic money institutions across the EU, it appears vital to regulate other emerging FinTech business models.

Taxation is a recurrent issue where a simplification is desirable in order to improve business environment.

4.3.3. EU financial instruments

Some participants in the CMU Working Group suggested using the EU financial instruments to support the development of local capital markets. For instance, Slovakia is planning to set up a fund financed by the European Structural and Investment Funds (ESIF) which would provide funding mainly to SMEs. In the view of Slovakia, a national or supra-national fund financed by ESIF or the

European Fund for Strategic Investment (EFSI), or directly by EIB could help mobilize additional capital in Europe and channel it where it's needed, in particular SMEs.

Austria suggests that International Financial Institutions (IFI), for instance the EIB, could further facilitate the development of capital markets in the CESEE region through products such as venture capital investment, securitization and credit guarantee schemes or project bonds.

With respect to EU financial instruments to support local capital markets, it is worth mentioning that there is another Working Group of the Vienna Initiative specifically looking at this matter.

Annex 1

EBCI Vienna Initiative



Terms of reference – Working Group on the Capital Markets Union

Endorsed at the Vienna Initiative Full Forum in Luxembourg on 6 March 2017

Background

The Capital Markets Union (CMU) is one of the EU priority actions, which aims at creating a single capital market in the EU, and for that purpose proposes a number of legislative and non-legislative initiatives. The overall objective of CMU is to mobilise capital in Europe and channel it to companies, including SMEs, and infrastructure projects so that they can expand and create jobs. By linking savings with growth, CMU offers new opportunities for both savers and investors.

The economic analysis accompanying the CMU Action Plan²³ identified areas where some Member States, including from Central Eastern and South-Eastern Europe (CESEE), still lag behind in terms of the level of development of their capital markets. Typically, the size of stock markets, corporate bond markets and venture capital/private equity markets is much smaller in CESEE countries. According to some calculations, the depth of capital markets in Central and Eastern Europe is 1/3 of EU average. One consequence is that business expansion relies on bank credit or retained earnings.

The Commission places strong emphasis on the development of capital markets and non-bank finance in countries with high catch-up potential. A number of the CMU actions – relating to strengthening venture capital and promoting growth markets adapted to the needs of small companies - will be particularly relevant in these Member States. However, these solutions need to be configured to take account of the typically smaller size profile.

Most differences in financial structures across countries stem from legal and historical factors and from the interdependency between economic and financial structures themselves. For example, the CESEE countries have only been building pension reserves and institutional capital for 25 years whereas these pools of savings play a critical part in supporting capital market development. Factors such as limitations on administrative and institutional capacity also are likely to play a role. There may be also reasons linked to national legal frameworks (e.g. company law, insolvency framework, taxation) or lack of an appropriate business environment (e.g. efficiency of the company register, functioning agencies or platforms for SMEs seeking finance, the operation of agencies promoting foreign investment, or even lack of trust and confidence of investors, etc.).

Key objective

The key objective of the Working Group will be to identify the most significant gaps in the capital market regulatory and institutional frameworks of the CESEE countries in terms of funding investment needs, and to identify the most promising channels for capital market development, taking account of the different business and economic structure of the countries concerned.

Topics to be covered

²³ http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-economic-analysis_en.pdf

The Group will look into different types of barriers, such as structural, legal, commercial, etc., and will assess them from the point of view of companies (including SMEs) as potential issuers, and investors (both institutional and individual). It will identify the conditions which must be met to create more diversified financial markets in the CESEE region, where bank funding would be complemented by strong capital markets thus giving firms a greater financing choice.

It will be also essential to evaluate cross-border aspects and identify potential synergies between capital markets in the CESEE region. To this end, the Group will assess which CMU actions could be coordinated for a more efficient implementation by the CESEE countries. It will also examine the comparative advantages of the national capital markets, both within the region, and broader *vis a vis* other European countries.

Output

The Working Group will produce a report presenting the most important points of the discussion and proposing solutions necessary for further development of capital markets in the CESEE region and to meet the CMU objectives.

Deadline

End 2017

Composition

Each Vienna Initiative member will nominate one or two representatives having a strong capital market background from a relevant national public or private sector entity (e.g. local stock exchanges, development banks, SME financing agencies, corporate finance). Besides, the group may include the ECB and ESMA observers. The European Commission will chair the working group and provide its temporary secretariat. The group's membership should not exceed 40 participants.

Communication

The report will be presented for endorsement at the 2018 Full Forum meeting and will be published on the VI website.

Next steps

The first meeting, hosted by the European Commission, will be held on 4 April 2017 in Brussels. Its objective will be to launch the work-stream and agree on main subject and the methodology of the report. The follow-up will be also decided with a view to finalizing the draft report by end 2017.

Budget

Each participant institution covers its own costs.

Participation in the Working Group

Expressions of interest to become member of the Working Group should be sent to fisma-vi@ec.europa.eu.

Annex 2

VIENNA INITIATIVE WORKING GROUP ON CAPITAL MARKETS UNION COUNTRY SURVEY 2017

Country: [...]

Assessment by: [institution]

Date: ../../2017

The objective of the survey is to collect information on the capital markets in each participating country. It aims to gather information on challenges and impediments as well as potential solutions and areas for improvement. The provided input will feed into the country chapters in the Working Group's report.

The proposed key aspects for assessment are as follows:

a) Challenges and impediments to capital markets development

- structural (e.g. size of the market, ownership, lack of savings and insufficient pool of institutional investors, dominating SMEs and high IPO-related costs for businesses)
- regulatory (at the national or EU level, e.g. lack of regulation, excessive regulatory burden, lack of harmonisation)
- supervisory (e.g. lack of skills, lack of proper guidance, weak enforcement of regulation by supervisors)
- cultural (e.g. preferences of entrepreneurs, lack of equity culture, distrust of individual investors towards capital markets)

b) Potential solutions and areas for improvement: at national and cross-border level

- structural (e.g. support from EU structural funds, cross-border projects and cooperation, SME-specific IPO solutions)
- regulatory (e.g. revision of regulation, streamlining of administrative burden, regulatory facilitation, e.g. "sand boxes")
- supervisory (e.g. training for supervisors, improved enforcement)
- cultural (e.g. incentives for SMEs, investor education programmes)

The assessment of the above proposed types of challenges and solutions may be carried out based on selected market segments and relevant categories of investors, depending on the specific features of each national market. For reference, **the main capital market segments** cover the market infrastructure, stock market (main regulated market, SME growth market), bond market (sovereign; corporate; covered bonds), securitisation and other instruments such as crowdfunding or fin-tech industry. The **investor types** include institutional investors (banks, insurance companies, pension funds, investment funds, private equity; venture capital and business angels) and retail investors.

Please provide concise input, highlighting key challenges and focusing on relevant proposals for policy solutions at the national, regional and EU level.

Thank you for sending your reply to: fisma-vi@ec.europa.eu by **31 May 2017**.