Brussels,
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BVI[1] views on the European All Shares Index Family proposal (EUASIF)

Executive Summary

The European All Shares Index Family (EUASIF) is a proposal aimed at creating a comprehensive range of indices to cover various aspects of the EU capital markets. The idea, initially outlined by the think tank CEPS in 2020, seeks to eliminate geographical labels in capital markets that negatively impact smaller and newer EU member states. The EUASIF would include indices such as the EU All Share Index, thematic indices like the EU ESG Index, size indices like the EU Microcap Index, and sectoral indices like the EU Manufacturing Index. These indices are designed to provide a detailed representation of the EU capital markets, promoting market integration and development across various sectors and company sizes.

The EUASIF is expected to have significant impacts on smaller EU markets, boosting the Savings and Investments Union (SIU). It aims to increase visibility and market liquidity, enhance access to capital, and foster market integration by eliminating geographical labels. The creation of sectoral and thematic sub-indices, including those focused on ESG criteria, could also support sustainable and responsible investing. The EUASIF could be implemented through the value-added services of the consolidated tape (CT) within the MiFIR reform, which aggregates market data from multiple trading venues. This would provide a comprehensive view of the market, improving data quality and consistency. The EUASIF is designed to complement existing indices, providing a unified representation of the EU capital markets and increasing the visibility of smaller markets within the EU.

The European All Shares Index Family

The idea of a European All Shares Index Family (EUASIF) dates back a few years. The think tank CEPS outlined the idea in a report commissioned for the European Commission in 2020:[2]

> *"The idea is that the creation of a CMU all-share index, as well as CMU sectoral and thematic sub-indices, entails the elimination of capital markets' geographical labels. These are typical of the current classifications of capital market and weigh negatively on small and new EU member states. Eliminating them could help to attract both large investors and more funds towards smaller capital markets. At the same time, a wide use of such new indices would foster EU capital market integration."*

[1] BVI represents the interests of the German fund industry at national and international level. The association promotes sensible regulation of the fund business as well as fair competition vis-à-vis policy makers and regulators. Asset managers act as trustees in the sole interest of the investor and are subject to strict regulation. Funds match funding investors and the capital demands of companies and governments, thus fulfilling an important macro-economic function. BVI's 115 members manage assets of EUR 4.4 trillion for retail investors, insurance companies, pension and retirement schemes, banks, churches and foundations. With a share of 27%, Germany represents the largest fund market in the EU. BVI's ID number in the EU Transparency Register is 96816064173-47. For more information, please visit www.bvi.de/en.

[2] This study is available online: https://www.ceps.eu/ceps-publications/feasibility-study-for-the-creation-of-a-cmu-equity-market-index-family/

The EUASIF could include a comprehensive range of indices designed to cover various aspects of the EU capital markets. For example:

- **EU All Share Index**: covering around 3,600 companies headquartered in the EU-27 and listed on one of the EU-27 regulated markets and SME growth markets.
- **Thematic Indices like an EU ESG Index**: with a focus on companies with strong Environmental, Social, and Governance (ESG) practices;
- **Size Indices**: such as an EU Micro Cap Index comprising companies with very small market capitalization;
- **Sectoral Indices** such as an EU Manufacturing Index, comprising companies in the manufacturing sector or an EU Banks & Financial Services Index (with a focus on banks and financial services companies).

These indices are designed to provide a comprehensive and detailed representation of the EU capital markets, promoting market integration and development across various sectors and company sizes.

The advantages of a European All Shares Index Family

Importantly, the EUASIF is expected to have a number of significant impacts on smaller EU markets which in turn could boost the **EU Savings and Investments Union (SIU)**:

- **A lighthouse for SIU in the securities area**: There is a lack of visibility of the European Union in the securities area as there are no pan-European securities or exchanges accessible for the ordinary citizen. A pan-European all shares index, visible daily in major retail and institutional media, could serve as a psychological anchor for the SIU, similar to SEPA cross-border payments and the single currency on the payments side.
- **Increased visibility**: Including smaller markets and companies in the indices will enhance their visibility to a broader range of investors, attracting both domestic and international investment, which is crucial for the growth and development of these markets.
- Resulting in **increased market liquidity**. As these stocks become part of widely followed indices, increased trading activity is expected, reducing bid-ask spreads and facilitating the trading of these securities. This could also lead to more capital inflows into smaller markets through index tracking funds.
- **Enhanced access to capital:** Including smaller companies and markets that are currently excluded from major indices will provide these entities with better access to capital markets financing, particularly benefiting SMEs, **through increased investor interest.**
- **Market integration**: The EUASIF aims to eliminate geographical labels in capital markets, fostering greater integration and interconnectivity across the EU – thereby reducing market fragmentation of European capital markets. Both international and domestic investors will perceive European markets as one more cohesive unit, leading to more efficient capital allocation and better risk diversification.
- **Support for ESG and thematic investments**: The creation of sectoral and thematic sub-indices, including those focused on ESG (Environmental, Social, and Governance) criteria, could support the growing interest in sustainable and responsible investing, attracting investors who are seeking to align their investments with their values.
- **Cost efficiency**: The use of the EUASIF could be relatively inexpensive, potentially even free of charge, making it an attractive option for investors and fund managers. This could lower the barriers to entry for investing in a broader range of EU markets.

Overall, the EUASIF aims to foster a more integrated and dynamic capital market environment in the EU, with benefits for smaller markets and companies that are traditionally underrepresented in major indices. This is also shown by the CEPS study on the feasibility of a European index family:

> *Data suggest that, in the EU, only about half of the equity markets that are classified as developed markets are included in the indices provided by the most popular independent index providers, such as MSCI and FTSE Russell. In practice, only the large caps are part of such indices. Not being included in such indices puts the smaller markets in Central, Eastern and Southeastern Europe at a significant disadvantage.*[3]

However, despite the clear benefits of a European index family, the idea did not come to fruition at the time:

> *"The fact that an equity-based index covering all EU countries does not exist does not mean there is no demand for equity indices covering shares listed at regulated and growth markets across the entire EU. Yet in the current market structure, supply for such an index lacks demand."*[4]

Consequently, no (commercial) provider emerged.

<u>The time is now right to push the Savings and Investments Union with the European All Shares Index Family</u>

Since 2020 the circumstances have changed. Firstly, reports by the Eurogroup, Enrico Letta[5] and Mario Draghi[6] provide recommendations on how to increase institutional and retail investments in companies listed in the European Union. A European Index Family would improve non-bank financing of the SME sector, and more generally, the financing of the transformation of the economy, improving infrastructure, enabling the Digital Union, and improving funded retirement provision of its citizens.

Also, the Niinistö report „Safer Together – Strengthening Europe's Civilian and Military Preparedness and Readiness"[7] calls for leveraging private capital for preparedness action by providing investment opportunities for EU citizens and institutional investors. As an example of this, the European Commission and the European Investment Bank could encourage EU-based financial institutions to create a series of preparedness-themed benchmarks targeting EU companies in crisis-relevant sectors and support their uptake through proactive communication. This could include defence technology and manufacturing, cybersecurity and intelligence-related technologies, health and medical supplies, companies producing goods relevant for emergency response (e.g. shelter), or companies investing in secure supply chains for critical goods. For example, such benchmarks used in actively managed or in passive thematic ETFs could provide EU citizens and investors with easily accessible investment

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[3] According to the current MSCI market classification, only 12 Western European EU countries are classified as "developed markets". The Czech Republic, Greece, Hungary and Poland are covered in "emerging market" indices. Only another 6 countries are at least "frontier markets"; other EU countries – notably Bulgaria and Malta – are not even included in the MSCI Emerging Markets Index or MSCI Frontier Markets Indices
Source: MSCI, available at https://www.msci.com/our-solutions/indexes/market-classification

[4] CEPS, 17 Sep 2020, Fostering capital market integration - Is there a role for a CMU equity market index?, available at: https://www.ceps.eu/fostering-capital-market-integration/

[5] The CMU report by Enrico Letta is available here: https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf

[6] The CMU report by Mario Draghi is available here: https://commission.europa.eu/topics/strengthening-european-competitiveness/eu-competitiveness-looking-ahead_en

[7] Available at: https://commission.europa.eu/topics/defence/safer-together-path-towards-fully-prepared-union_en

opportunities, while also contributing to enhancing the EU's resilience and preparedness. These thematic products would need a dedicated EU sector index to be able to operate.

The EU's financial markets are highly fragmented, with significant differences in market structures, regulations, and liquidity across member states. This fragmentation makes it difficult to create a cohesive and widely accepted index family that can effectively represent the entire EU market. This is about to change with the **implementation of the Consolidated Tape (CT) within the MiFIR reform**. While the CT aggregates pre- and post-trade data from multiple trading venues into a single, standardized feed, **providing a comprehensive view of the market by consolidating data from various sources**, traditional market data sources typically provide data from individual trading venues, meaning users may need to subscribe to multiple data feeds to get a complete market picture, which can remain fragmented and inconsistent. Compared to traditional market sources, where data users (such as asset managers) need to negotiate for data access from various sources to get a complete market view, the CT provides a more comprehensive view of the market by including data from multiple trading venues. Consequently, this improves the overall quality and consistency of market data. Currently, ESMA is working on the selection process for an EU equity and ETF consolidated tape provider (CTP) which will receive authorization and operate by 2026.

For example, a consortium of 14 EU exchange groups called "EuroCTP"[8] shows interest in launching a consolidated tape. The CTP will collect the core market data, i.e. the quotes and prices of EU listed shares and ETF and will make them available to users on a real-time basis. The CTP will receive the quotes and prices from the various trading venues and approved publication arrangements (APA) without the need to reimburse the data contributors. The CTP could offer certain value-added services. In this context, value-added services refer to additional services provided by trading venues and data reporting service providers that go beyond the basic regulatory requirements. Such services are designed to enhance the overall functionality and value of the market infrastructure and are intended to provide market participants with additional resources and capabilities that enhance their trading experience, improve compliance, and support better decision-making processes. In the spirit of these additional services, the CTP could therefore take the already collected market data and use them not only to disseminate them to its users but also use the data as the basis to calculate the EUASIF. The CTP could do this either directly or outsource the calculation of the index family for a fee, for example to an SME-sized and EU-based commercial provider, such as Solactive or EDHEC.

Similarly, the EU could directly appoint an index provider (BMR compliant firm) with the production of the EUASIF using the (for free) available CTP data set. **The index could be offered on a low-cost basis as the CT aims to liberalize the availability of market data which in turn makes market data more affordable and accessible to a broader range of users, including retail investors**. The CTP index pricing power is limited as it operates under the reasonable commercial basis model (RCB – Art. 13 MiFIR) which requires that pre-trade and post-trade data be made available to the public at a cost that reflects the cost of producing and disseminating the information, plus a reasonable margin. This principle aims to ensure that the fees and contractual terms for accessing market data are fair, non-discriminatory, and transparent, avoiding monopolistic practices and promoting competition. Therefore, the CTP will be enabled to offer an EUASIF on a low-cost basis after the introduction of the equity CTP in 2026.

[8] More information available here: https://www.euroctp.eu/about

The European All Shares Index Family would increase the visibility of smaller markets

There is an awareness gap among international investors regarding the opportunities in smaller EU markets. This unfamiliarity can lead to a preference for more established and well-known markets, limiting the interest in a new index family that includes less prominent markets. Moreover, **many smaller EU markets and companies suffer from limited liquidity and free float, which can deter large institutional investors from participating**. These markets often have lower trading volumes and higher transaction costs, making them less attractive for inclusion in major indices. Therefore, **there is a public interest in increasing the visibility of European markets.**

How could this All-Shares Index Family be implemented?

Based on the idea of the value-added services of the consolidated tape, this index family could be implemented now through specific policy decisions without the need for new legislation. While market participants shape market outcomes, public authorities and the European Commission can still play an important role in raising awareness of new opportunities and creating an environment that can foster change by sponsoring and financing the EUASIF offer by the CTP for a limited period, e.g., five years. During this period, the EUASIF will be able to create a brand which will lead to investor awareness and usage.

This public start-up funding would be limited in time. Once established, the index family could generate revenue through licensing fees paid by financial institutions and asset managers who use the indices for benchmarking and investment products. This market-driven revenue model would help ensure the long-term sustainability of the index family. Examples for use cases could be derivatives or the use as a benchmark for active fund management or for index tracking funds which potentially lead to more capital inflows into smaller markets. As a low-cost index product by design, the EUASIF should facilitate usage, especially for index funds where the cost for the underlying index amounts already today to 10-20 % of overall fund costs according to a recent FCA study[9]. As the EUASIF aims to provide a comprehensive representation of the European equity markets, it includes smaller and less liquid markets that are often underrepresented in existing indices from major providers. Therefore, it addresses the coverage gap because many existing indices focus primarily on larger, more liquid markets within the EU. Moreover, this index family would be based on data delivered from the CT and offered as an added-value services which is also an option for traditional index providers. While the index provision industry is currently dominated by a few large players, the introduction of the EUASIF could change this dominance by providing a new, competitive alternative that challenges the status quo and offers investors more choice.

[9] The FCA study is available here: https://www.fca.org.uk/news/press-releases/financial-regulator-finds-wholesale-data-market-can-be-improved.

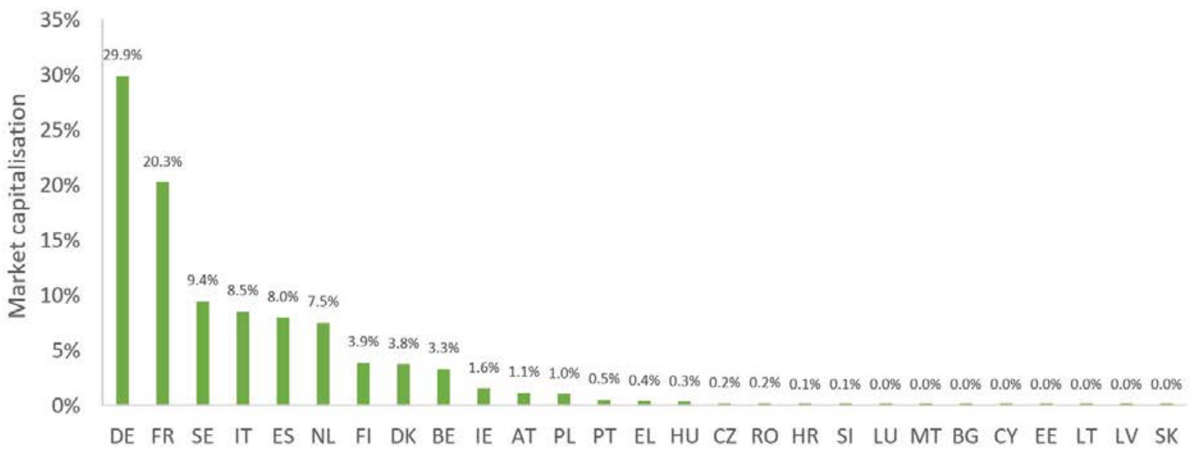
<u>The European All Shares Index Family as an addition to established indices</u>

Importantly, this European Index Family does not aim to replace established and existing indices – but rather to complement the existing offers on the market. While the EU has been struggling to integrate its capital markets for decades, progress has been very limited. European capital markets remain fragmented and it is challenging to raise international capital.

In the words of CEPS:

> *There are still 27 national capital markets, which do not function as one. Some of them are quite developed and large, but most are small and unable to provide a meaningful alternative to acquire sources of finance for capital expenditure and business combinations. Such markets are often classified as 'emerging markets' or 'frontier markets' and are only of marginal interest to international institutional investors.*

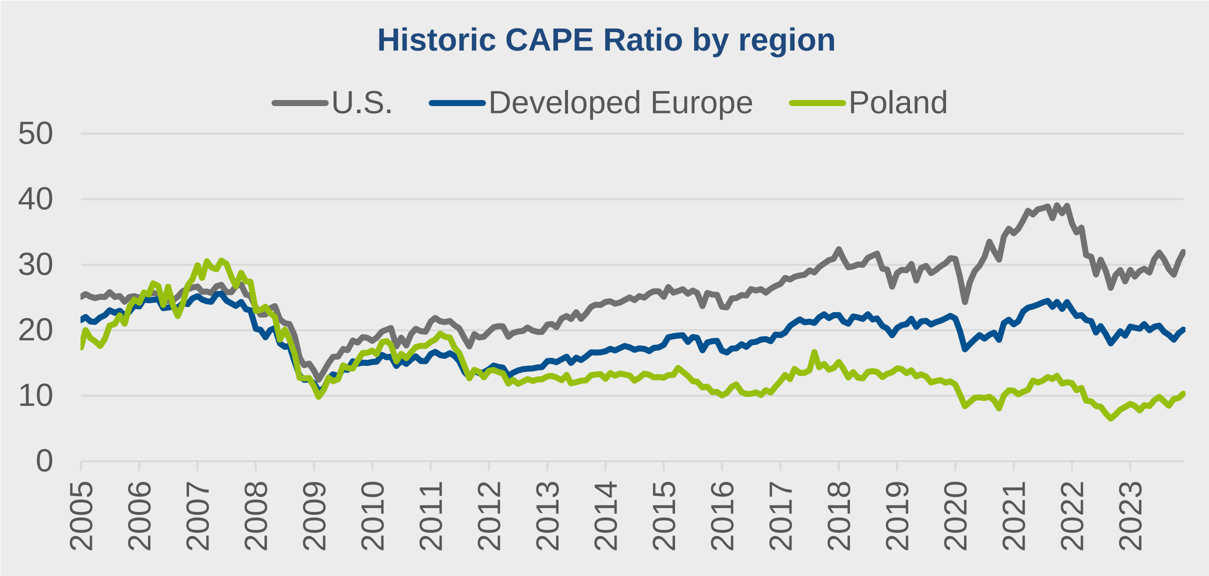
Figure 1. Geographical distribution by market capitalisation



Note: This figure is based on December 2019 free-float market capitalisation of companies listed at EU regulated markets and SME Growth Markets, which in total amounted to close to €5,400 billion.

Source: CEPS (2020).

As a result, even for larger companies, equity valuations are significantly lower in these markets. In the 2005-23 period, the cyclically adjusted price-to-earnings ratio (CAPE) amounted to 25.7 for US stocks, 19.1 for Western European equity and only 14.8 for Polish stocks, for instance. This implies higher burdens to raise capital for companies from many EU member states.



Source: Barclays Research[10]

In the EU, only about half of the equity markets classified as developed are included in indices from major independent providers like MSCI and FTSE Russell. These indices primarily feature large-cap stocks. Consequently, smaller markets in Central, Eastern, and Southeastern Europe face significant disadvantages by not being included.

The EUASIF is designed as an addition to established indices. While the vast majority of the more than 7,300 companies listed on EU-regulated markets[11] are micro caps or small caps, the approximately 300 largest listed Euro Area companies included in the EURO STOXX index alone account for about two thirds of total EU market capitalisation.[12] Moreover, the EU-listed companies are included in approximately 5,000 indices provided by stock exchanges and independent providers[13] (e.g. Stoxx and MSCI). Although the index issuers provide all-share as well as a variety of size, thematic and sectoral indices, none of them covers the stock exchanges from all EU countries. Therefore, the EUASIF could contribute to the existing indices and thereby complement the repertoire.

Consequently, the question arises as to what measures could reduce fragmentation and improve access to finance for companies, particularly for smaller companies in small countries with less developed capital markets.

By creating a comprehensive index that includes all listed companies in the European Union, the EUASIF could provide a unified representation of the EU capital markets. This would help to eliminate the geographical labels that currently segment the market, making it easier for investors to view the EU as a single, cohesive market. The EUASIF, however, would not just reduce market fragmentation by providing a full picture of the European capital market in the spirit of the Consolidated Tape (CT), but

[10] Available at: https://indices.cib.barclays/IM/21/en/indices/static/historic-cape.app
[11] According to The World Federation of Exchanges, about 5,600 domestic and 1,700 foreign companies listed were listed on EU stock exchanges as of Feb 2024; available at: https://focus.world-exchanges.org/issue/april-2024/market-statistics
[12] Total market cap of EURO STOXX index constituents as of Feb 2024: USD 8.4 billion (Link), total market cap of domestic listings on EU exchanges in Feb 2024: EUR 12.4 billion (Source: WFE)
[13] Study by CEPS/ ECMI available at: https://op.europa.eu/de/publication-detail/-/publication/050b047e-3ff5-11ef-865a-01aa75ed71a1

would also increase the visibility of smaller markets within the EU. Including smaller in the broader market indices would improve the visibility of the market and consequently allow their listed companies to attract more attention from international investors.