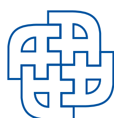

fundación ICO

2. THE CAPITAL MARKETS UNION: A PATH TOWARDS A GREATER UNION

Yolanda Azanza, Carlos Pérez Dávila y Francisco Pizarro[1]

A day will come when all nations on our continent will form a European brotherhood ... A day will come when we shall see ... the United States of America and the United States of Europe face to face, reaching out for each other across the seas.

Victor Hugo, International Peace Congress, 1849

RESUMEN EJECUTIVO

Desde la creación de la Comunidad Económica del Carbón y del Acero en los años 50, el primer paso significativo hacia la creación de la actual Unión Europea (UE), los esfuerzos por unir a los estados europeos han permitido superar la devastación del continente que siguió a la Segunda Guerra Mundial y han permitido que la región viva más de medio siglo de prosperidad y desarrollo.

A día de hoy, los Estados miembros de la UE comparten un mercado único basado en unas políticas europeas orientadas a posibilitar la libre circulación de personas, bienes, servicios y capitales. El espacio Schengen ha eliminado los controles de pasaportes en su territorio y desde comienzos del siglo pasado una mayoría de Estados miembros comparten una moneda única.

El progreso de la UE hasta la fecha ha sido muy significativo y, sin embargo, la tarea de construcción europea continúa siendo ingente. En este sentido, una de las prioridades de la actual Comisión Europea es reforzar la economía de la región, severamente castigada por la reciente crisis, así como potenciar la inversión al objeto de estimular el crecimiento y la creación de empleo. Para potenciar la inversión a largo plazo, Europa necesita unos mercados de capitales más desarrollados que permitan a las empresas el acceso a nuevas formas de financiación y a los ahorradores diversificar sus opciones de inversión y, con ello, reforzar la economía en su conjunto. Con este objetivo, se encuentra entre las prioridades de la Comisión la creación de un mercado único de capitales para los Estados miembros.

En este sentido, cabe destacar que a pesar del progreso realizado en los últimos 50 años, los mercados de capitales en la UE continúan poco desarrollados, especialmente si

[1] Clifford Chance.

se comparan con sus equivalentes norteamericanos, donde la financiación del tejido empresarial depende en menor medida de la financiación bancaria y, por tanto, sus empresas son menos vulnerables en caso de contracción del crédito bancario. La reciente crisis financiera ha reducido los niveles de integración de los mercados de capitales a nivel europeo.

La Comisión considera que una Unión de los Mercados de Capitales permitirá (i) canalizar más inversión hacia el tejido empresarial europeo, (ii) conectar de forma más eficiente la financiación disponible con los proyectos de inversión en la UE, (iii) fortalecer el sistema financiero en su conjunto mediante una mejor redistribución del riesgo y (iv) reforzar la integración financiera y la competitividad de la UE.

Con estos objetivos, la Comisión publicó en febrero de 2015 un Libro Verde sobre la Unión de los Mercados de Capitales así como dos consultas sobre titulizaciones «simples, estandarizadas y transparentes» y sobre una nueva Directiva de Folletos, dos de los pilares fundacionales de la Unión de los Mercados de Capitales.

Con las aportaciones recibidas, en septiembre de 2015 la Comisión publicó un Plan de Acción integrado por más de una treintena de medidas concretas encaminadas a la construcción de una verdadera Unión de los Mercados de Capitales en 2019. En dicho Plan de Acción, se identificaron las siguientes prioridades: (i) proporcionar más opciones de financiación a las medianas y pequeñas empresas europeas, (ii) articular un marco regulatorio propicio para la inversión a largo plazo en las infraestructuras europeas, (iii) incrementar las opciones de inversión de particulares e inversores institucionales, (iv) reforzar la capacidad de financiación de las entidades de crédito y (v) eliminar las barreras a la inversión transfronteriza. En vista de la experiencia adquirida, la Comisión ha llevado a cabo recientemente una actualización y mejora del Plan de Acción de 2015.

Este artículo analiza las prioridades identificadas en el Plan de Acción y proporciona una visión global del progreso alcanzado hasta la fecha en cada una de ellas, con especial énfasis en aquellas donde el progreso ha sido más significativo (tales como las cuestiones relativas a la nueva regulación de folletos o la nueva regulación europea en materia de titulización).

2.1. INTRODUCTION

Since the creation of the European Coal and Steel Community in the 1950s, the first significant step towards the creation of the current European Union (EU), the efforts to unite the European countries have allowed us to overcome the devastation of the continent that had followed the Second World War and have resulted in more than half a century of prosperity and development.

Today, the Member States of the EU share an internal single market based on EU policies aimed at ensuring the free movement of people, goods, services and capital. The Schengen Area has also abolished passport controls and since the beginning of the twentieth century most of its Member States share a common currency.

The progress made to date is enormous, as Victor Hugo's vision becomes a reality closer within reach, but a huge amount of work remains ahead. In this regard, one of the

EU Commission's current top priorities is to strengthen Europe's crisis-hit economy and enhance investment with the ultimate purpose of stimulating grown and creating jobs. To promote investment over the long term, Europe needs stronger capital markets which are capable of providing new sources of funding for business, increase options for savers and make the economy more resilient. It is with this view that the Commission has prioritised the need to build a true single market for capital: a Capital Markets Union for all Member States (the «**CMU**»).

Despite the progress made over the past 50 years, Europe's capital markets remain underdeveloped and fragmented, especially if compared to American capital markets where business finance is less bank-dependant and businesses are less vulnerable to a tightening of bank lending. The recent financial crisis has reduced the level of integration, with banks and investors retreating to their home markets.

The Commission believes the CMU will: (i) unlock more investment from the EU and the rest of the world, thereby offering businesses more choices of funding, (ii) better connect financing to investment projects across the EU, (iii) make the financial system more stable by sharing financial risks and (iv) deepen financial integration and increase European competitiveness.

With these objectives in mind, the Commission launched in February 2015 a Green Paper on building a CMU, seeking the opinions of capital markets players (the «**Green Paper**»). Two technical consultations on «simple, standard and transparent» securitisation and the Prospectus Directive were launched alongside the Green Paper.

Based on the feedback received, the Commission adopted in September 2015 an action plan comprising more than thirty measures for creating a CMU by 2019 (the «**2015 Action Plan**»). In such plan, the Commission identified the following priority areas: (i) providing more funding choices for Europe's businesses and small and medium-sized enterprises («**SMEs**»), (ii) ensuring an appropriate regulatory environment for long term and sustainable investment and financing of Europe's infrastructure, (iii) increasing investment choices for retail and institutional investors, (iv) enhancing the capacity of banks to lend and (v) bringing down cross-border barriers and developing capital markets for all Member States.

This article provides an overview of the reasons why these have been identified as priorities, as well as an assessment of the progress achieved to date.

Following the CMU's First Status Report and considering the Commission's desire to accelerate the reforms, the Commission has recently undertaken an assessment exercise which began with a public consultation on the status of the CMU, followed by a formal review of the 2015 Action Plan published in June 2017 (the «**Mid-Term Review**»). The purpose of the public consultation was to give stakeholders the opportunity to provide their input on how the 2015 Action Plan could be updated and completed. Feedback on the consultation identified the following main challenges: (i) the need for start-up and scale-up firms to have more access to risk finance, (ii) the need to reduce the cost of accessing public markets, (iii) the contraction in bank loans to EU businesses, (iv) the need to increase investment by insurance companies and pension funds in venture capital, equity and infrastructure, (v) the need to increase engagement by retail investors with capital markets and (vi) the need to reduce barriers to cross-border investment.

Drawing on the responses to this public consultation, the Commission has published the Mid-Term Review, in which, in light of the new circumstances (including Brexit), it has updated the 2015 Action Plan with new sub-areas for action. The Mid-Term Review places significant emphasis on the desire to strengthen the integration and effectiveness of EU supervision and on the need to integrate sustainability into the EU's regulatory and financial policy framework. The new sub-areas for action arising from the Mid-Term Review are addressed in this article.

2.2. FINANCING FOR INNOVATION, START-UPS AND NON-LISTED COMPANIES

Financing of start-up companies («**Start-ups**») and SMEs is one of the main concerns of the Commission in its CMU initiative. Providing business in any stage of development with a greater choice of funding at a lower cost has been consistently stated as one of the main objectives of the CMU initiative. Notwithstanding that, the main focus of the Commission has always been on Start-ups and SMEs, since they are considered by the Commission as crucial for the future of jobs and economic growth in Europe and also because they typically display initial low levels of cash flow and are dependent on external finance to grow.

2.2.1. *SUPPORTING VENTURE CAPITAL AND EQUITY FINANCING*

The Commission identified that Start-ups and scale-up firms need diversified sources of finance (including more risk finance) and that there is a need to develop and strengthen new forms of emerging risk capital. Venture finance and 'business angels'[2] can play an important role in addressing these needs.

New rules for developing legislation on European Venture Capital Funds («**EuVECA**») and European Social Entrepreneurship Funds («**EuSEF**») have been approved. These new rules are in line with what was suggested in the 2015 Action Plan: opening EuVECA and EuSEF to fund managers of all sizes, allowing a greater range of companies to benefit from EuVECA and EUSEF investment, improving investors' access to small and growing businesses and social ventures, and making the cross-border marketing of EuVECA and EuSEF funds less costly and simple.

In addition, the Pan-European Venture Capital Fund(s)-of-Funds Programme by means of which a private-sector led, market-driven pan-European venture capital fund(s)-of-funds is intended to be created, has been established. This programme aims to address Europe's equity gap and the fragmentation of the venture capital market, and to attract additional private funding from institutional investors into the EU venture capital asset class. As of December 2017, the European Commission and the European

[2] The Commission documentation defines 'business angels' as individual investors, usually with business experience, who provide capital for Start-ups.

Investment Fund were selecting promoters for these pan-European venture capital fund(s)-of-funds.

Among the multiple factors that are material to an environment which encourages venture capital or business angel investment and that drive this type of investment, the Mid-Term Review identifies «good practice on tax incentive schemes for venture capital and business angel investments» as an action to be undertaken.

As pointed out in the Tax Incentives Report (defined below), the tax incentives for venture capital and business angels typically consist of a combination of up-front tax benefits, relief on income generated over the life of the investment (these being somewhat less relevant) and relief on gains realized upon the disposal of the investment.

The imposition of tax incentives is mainly a domestic matter where the taxation policy of each country is essential. Consequently, it is not uncommon to find remarkable differences between the EU Member States, resulting in a fragmentation of the status and position in this regard across the EU.

The Commission services have reviewed national tax incentives for venture capital and business angels and in June 2017 published a report on this matter[3] (the «**Tax Incentives Report**»), which aims to support the design and implementation of tax incentive policies by EU Member States. The Tax Incentive Report contains several recommendations to policymakers, including a list of desirable features.

2.2.2. *OVERCOMING INFORMATION BARRIERS TO SME INVESTMENT*

Information barriers were identified in the Green Paper as one of the main problems that had to be overcome in order to improve access to finance for SMEs and to widen their investor base. These barriers might not be so significant for bank lending, but they hinder other sources of funding. Therefore, since one of the main objectives of the CMU initiative is to reduce the dependence on bank lending and increase the availability of financing options from capital markets, the reduction of information barriers is an important goal to be achieved. Often SMEs are not aware of the existence of alternatives to bank financing and informing SMEs of these diverse options is as important as creating them. But the information barriers do not only affect the SMEs seeking finance, they can also affect finance providers (since sometimes SMEs are not even visible to prospective local and pan-European investors).

The barriers identified by the Commission include the lack of financial knowledge, the lack of a recognised source of business advice for SMEs (which includes adequate feedback from banks on declined credit applications –certain actions in this regard are currently being implemented) and the lack of standardised, verifiable and accessible financial information about SMEs.

As a result of actions in this regard envisaged in the 2015 Action Plan, in June 2017 the Commission Staff Working Document Addressing Information Barriers in the SME

[3] Effectiveness of tax incentives for venture capital and business angels to foster the investment of SMEs and Start-ups.

Funding Market in the Context of the CMU (the «**Information Barriers Document**») was published. This document describes initiatives that have been taken by some Member States and regions to improve the flow of information to small business. The measures described in the Information Barriers Document include one-stop portals on access to finance, advisory services portals, accreditation systems for alternative finance providers, matchmaking platforms connecting SMEs with investors and lenders, credit registries and credit bureaus that provide credit reports.

As for the current status of work in this area, the main activity is the call on improving access by innovative SMEs to alternative forms of finance made in April 2015 within the context of the Horizon 2020 programme (an EU programme to fund research and innovation projects) that is expected to result in up to three projects in this area of work being funded by the Commission.

2.2.3. *PROMOTION OF INNOVATIVE FORMS OF CORPORATE FINANCING*

Within its objective of providing business with a greater choice of funding options, the Commission has analysed alternative means of financing (in January 2017 the Commission published its Final Report on Assessing the potential for crowdfunding and other forms of alternative finance to support research and innovation) and has made efforts to develop them. Work in this regard has already been completed (e.g. the Crowdfunding Report (defined below) and the European Securities Market Authority («**ESMA**»)'s Opinion on Key principles for a European framework on loan origination by funds published in April 2016), but further efforts are still needed, as reflected by the two actions contained in the Mid-Term Review:

2.2.3.1. Harnessing the potential of Fintech

A connected digital single market is one of the political priorities of the EU Commission, which supports the overall objective of creating growth and jobs.

In this context, the Commission has highlighted in the Mid-Term Review that it is assessing how Fintech can contribute to deepening EU capital markets by integrating the potential of digitisation to change business models and make the single market for financial services more competitive, inclusive and efficient while ensuring financial stability, financial integrity and safety for consumers, firms and investors.

Fintech refers to the use of technology to enhance, deliver or support the provision of financial services. Significant attention has been paid to start-ups creating innovative applications, processes, products and business models in the delivery of financial services to challenge financial sector incumbents. The term may now be more broadly understood to include established corporates and financial institutions creating new or enhancing existing infrastructure, financial products and services and/or models through technology. Non-disruptive Fintech triggers incremental innovation and increases efficiency, whereas disruptive Fintech results in more radical breakthroughs

that can create completely new markets. Both can enhance the competitiveness of the EU economy. Nonetheless, Fintech also gives rise to challenges, such as cyber security and potential redundancy.

Within the Fintech concept, crowdfunding[4] has been a focus of the Commission, not only because it is an important alternative source of financing, but also because it can offer a wide range of other benefits: it can give a proof of concept and idea validation to project seekers, it can provide entrepreneurs with relevant information (since crowdfunding gives access to a large number of people), it can attract other sources of funding and it can be a marketing tool. As a sign of the importance given by the Commission to crowdfunding, the Commission set up a Crowdfunding Stakeholder Forum to support policy development in this area and launched a study to gather and analyse data on crowdfunding markets across the EU and assess the impact of national legislation. This study resulted in the Commission Staff Working Document: Crowdfunding in the EU Capital Markets Union (the «**Crowdfunding Report**») published in May 2016, in which the Commission concluded that crowdfunding is a technological innovation that has potential to transform the financial system.

Innovative businesses raise concerns that national supervisory practices may limit their ability to innovate and to offer services cross-border. Moreover, maturing Fintech companies actively seek regulation to gain consumer confidence.

Recently, regulators and supervisors in some Member States have developed methods to support the development of innovative businesses by working with them to understand their specific issues. These initiatives –called «regulatory sandboxes»– include hubs that provide guidance on applicable regulations and direct supervisory assistance while these firms are testing their activities.

The public consultation on Fintech launched on 23 March 2017 has provided the Commission with input on (amongst others): (i) whether new, more proportionate licensing arrangements for Fintech activities and firms in areas such as investment-based and lending-based crowdfunding are needed and (ii) how to support Fintech firms registered in one EU country and doing cross-border business, without requiring further authorisation in each EU country («passporting»).

Respondents to the public consultation agree with the Commission that Fintech has indeed the potential to drive financial sector development, but that it is not immune to risks, with cybersecurity and the use and control of personal data being amongst the predominant concerns of the industry.

One of the main areas where respondents expressed broad support for action at the EU level is that of licensing and the cross-border provision of services in a way which balances the dynamics of the industry with the protection of the various parties involved.

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[4] Crowdfunding is defined by the Commission as an emerging alternative form of financing that connects those who can give, lend or invest money directly with those who need financing for a specific project. It usually refers to public online calls to contribute finance to specific projects.

In light of all of the foregoing, the Commission has identified, as a new key sub-area for action, the assessment of a case for an EU licensing and «passporting» framework for Fintech activities in the last quarter of 2017.

2.2.3.2. Developing supply chain finance

Supply chain finance is what is commonly known as invoice trading (e.g. factoring or confirming). It is a technique that benefits all the parties in the supply chain: it enables buyers to ease payment terms while also ensuring that the cash flow of the suppliers is improved allowing them to know precisely when they will be paid and plan their finances accordingly; thereby reducing instability within the supply chain. When companies face temporary cash flow problems —either if they are the buyers or the suppliers— is when these practices become especially useful.

Supply chain finance services have traditionally been provided by banks or other financial entities; however, new players are entering in this business, taking advantage of the new tools and solutions enabled by Fintech (e.g. peer-to-peer platforms). These new tools can, on the one hand, provide more options with which to carry out these receivable financing transactions (and this could lead to a reduction of costs), but on the other hand can increase operational risks and reduce flexibility, since there is no (or at least a less clear) direct line of communication between sellers and buyers of receivables. Moreover, change is not only expected on the part of the providers of supply chain finance services; those receiving these services are also expected to change, as these type of services may increasingly be rendered to Start-ups and SMEs.

Being aware that supply chain finance is an important technique for companies, that it benefits all parties in the supply chain and that it is rapidly evolving together with the development of Fintech (with the advantages and risks that this implies), the Commission, in its Mid-Term Review, has expressed its intention to produce a report on best practices in supply chain finance in order to provide support for its development.

2.2.4. *DEVELOPMENT OF A PRIVATE PLACEMENTS MARKET*

Besides being mentioned in CMU initiative documents since the Green Paper, the creation of a pan-European private placement market has been an aim for many European capital markets participants and has been the object of market-based actions for years in order to provide competition to the United States private placement market (that has been commonly used by European companies).

Private placements are a way of obtaining financing which consists of offerings of debt securities to a small number of institutional or experienced investors (and not involving a public offering). Within its objective of diversifying the sources of funding in the European economy, the Commission has seen private placements as a way to provide a cost-effective source to raise funds and to broaden the availability of finance

for medium to large-sized companies (and potentially infrastructure projects as well), with simple, standardised and quick transactions.

Back in 2015, the Commission mentioned in the Green Paper that the stage of development of private placement activities was different across the EU Member States and that there were important barriers to the development of pan-European markets (including differences in national insolvency laws, lack of standardised processes and documentation and lack of information on the credit worthiness of issuers). Although since 2015 there have been important market-based initiatives in this area[5], more work is still needed in order to create a European private placements market able to be used as a way for companies to raise funds.

In order to try to develop a private placements market in the EU, the Commission is currently working on recommendations on private placements (building on the experience of well-functioning national regimes, such as the *Schuldscheine* in Germany and the Euro-PP market in France). However, there is no certainty as to how each Member State will implement them (if they are implemented) and if the fragmentation across the EU with regard to the private placements regime will persist.

2.3. MAKING IT EASIER FOR COMPANIES TO ENTER AND RAISE CAPITAL ON PUBLIC MARKETS

Public capital markets can serve to unlock more investment by helping to bridge the gap between companies that need funding and potential investors. The Commission considers that standardisation, transparency on product features and consistent supervision and enforcement are key to achieving the objective of developing public capital markets. Balance and proportionality are also to be considered when designing the measures to develop public markets: the measures to be taken need to keep the right balance between avoiding unnecessary administrative burden and providing sufficient investor protection.

2.3.1. *PROSPECTUS FOR PUBLIC OFFERINGS*

The difficulties in producing the prospectus required in order to make an offer of securities to the public or to list securities on regulated markets have always been considered as one of the main obstacles to access to the public capital markets, and sometimes even as an unnecessary barrier that may deter companies (especially SMEs) from offering their securities to the public, thus reducing their funding options. Moreover, as

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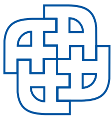
[5] Such as the publication of the Pan-European Corporate Private Placement Guide by the International Capital Markets Association (ICMA) in February 2015 (subsequently updated in October 2016), which is intended to provide a framework of best practices for European corporate private placement transactions, or the publication of complementary standard documentation by the Loan Market Association and the Euro PP Working Group.



the 2015 Action Plan pointed out, sometimes prospectuses are not the best tool to take investment decisions, since they may be complex and excessively detailed and the information that is critical for investment may be hard to discern.

As a result of the review process envisaged under the Green Paper and the 2015 Action Plan, a new prospectus regulation was published in June 2017[6] (the «**Prospectus Regulation**»). This represented a very important achievement within the objectives of the CMU initiative. The Prospectus Regulation admits that while disclosure of information is vital to protect investors by removing asymmetries of information and enabling them to take informed investment decisions, in certain situations the costs of producing a prospectus may be disproportionate or constitute an unnecessary burden. Although some of the measures provided in the Prospectus Regulation to avoid disproportionate costs or unnecessary burdens were already in place in the Prospectus Directive (Directive 2003/71/EC), new ones have been included. These new measures of the Prospectus Regulation include: a simplified prospectus for secondary offerings, a specific proportionate EU Growth prospectus regime, promoting the limitation of the risk factors and the summary and changes to the disclosure required.

The core content of the Prospectus Regulations will not enter into force until July 2019; but once this fundamental piece of legislation has been published, its implementing measures will be produced, thereby ensuring its proper application and the achievement of its objectives. The Commission is already working with the European Parliament, the Member States and ESMA to put in place implementing measures. Under its mandate from the Commission, ESMA is due to deliver technical advice to the Commission by 31 March 2018.

2.3.2. *PROMOTION OF SME LISTING*

Public markets offer access to a wide set of funding providers, help mobilise private capital to fund sustainable investment and also provide an exit opportunity for private equity and business angels. It is clear that public markets are an important tool for achieving the goals of the CMU initiative. However, as the Commission has admitted, accessing public markets is costly and complex, especially for SMEs, and the current regulatory environment may discourage SMEs from raising capital on the public markets.

Although work to promote access by companies to public markets has already been done with the publication of the Prospectus Regulation, the analysis of the bias in the tax system in favour of debt over equity and an assessment on how the public markets for SMEs are functioning and on potential barriers to SME listing (that is expected to result in a report that was expected to be published at the end of 2017), the Commission considers that further developments are still needed.

[6] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market and repealing Directive 2003/71/EC.

In this regard, in the Mid-Term Review, the Commission has identified four actions for this key sub-area, the priority being the need to explore whether targeted amendments to relevant EU legislation can deliver a more proportionate regulatory environment to support SME listing on public markets. The Commission will try to identify regulatory barriers to SME admission on regulated markets and SME Growth Markets targeting key sectorial legislation (e.g. MiFID or market abuse legislation). The second action identified under this key sub-area is an assessment of the impact of MiFID II level 2 rules on listed SME equity research. Although these assessments could be very helpful, legislators should also bear in mind that, despite the fact that regulation can represent a barrier to access to public markets, it provides investor protection and is a tool to increase investor confidence (especially that of retail investors) in the capital markets.

The third action established in the Mid-Term Review is to «monitor progress on IASB commitment to improve disclosure, usability and accessibility of IFRS». The Commission is aware that although the promotion of a single accounting language in the EU achieved through the International Financial Reporting Standards («**IFRS**») has played a key role in making it easier for large EU companies to have access to global capital markets (as it facilitates comparisons between companies and the process for taking investment decisions), the imposition of IFRS upon smaller companies can be a source of additional costs and make the listing process more burdensome. In this sense, the Commission has admitted that the development of a simplified, common and high quality accounting standard tailored to the companies listed on certain trading venues could be a step forward in terms of transparency and comparability and that, if applied proportionally, could help those companies seeking cross-border investors to be more attractive to them (also helping to break the home bias that has always characterised the equity capital markets).

Finally, the last action established under this key sub-area is to «develop best practices on the use by Member States of EU funds to partially finance costs borne by SMEs when seeking admission of their shares on the future SME Growth Markets». The SME Growth Markets were created, as a sub category within the multilateral trading facilities, by Directive 2014/65/EU[7] (the «**MiFID II Directive**») in order to facilitate access to capital for SMEs. The MiFID II Directive already shared the idea found in many of the CMU initiative documents of trying to find the right balance between reducing the burdens to listing and ensuring investor protection. The SME Growth Markets are seen by the Commission as a way to further develop local markets or young issuers.

2.3.3. *DEVELOPMENT OF CORPORATE BOND MARKETS*

As the Green Paper pointed out, bonds are mainly issued by large firms as opposed to SMEs and the issuances are concentrated in larger markets. If financing sources are to be diversified so that more alternatives are offered to European companies (and, ideal-

[7] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast).

ly, at lower costs), the development of such a relevant funding source as the corporate bond markets gains a remarkable importance.

When analysing what the problems of the corporate bond markets could be, the Commission found that the main problem was the limited liquidity in these markets (which, in turn, could translate into higher illiquidity premiums and higher borrowing costs). The Commission rapidly linked the limited liquidity with the low levels of standardisation and dedicated a key sub-area of the 2015 Action Plan to the review of the functioning of EU corporate bond markets, focusing on how market liquidity could be improved, the potential impact of regulatory reforms, market developments and voluntary standardisation of offer documentation. The Commission also formed an expert group to help it with such review and to identify actions that could contribute to the better functioning of the corporate bond markets. The outcome of the Commission review was published in November 2017.

Additionally, the development of corporate bond markets can also benefit from the enhancement of private placements (which, has been described above).

2.3.4. *PROPORTIONATE PRUDENTIAL REQUIREMENTS*

Investment firms and the services that they provide are a way to strengthen the link between savings and growth, but are subject to strict regulation and supervision (e.g. under MiFID II or CRD IV[8]/CRR[9]), with sometimes onerous prudential requirements. This regulatory environment increases the costs of accessing investment products. On the other hand, these regulatory constraints also increase investor confidence and protection and contribute to the stability of the capital markets. Once again, the Commission seeks the right balance between investors' confidence and protection and boosting investment (in this case, especially retail investment).

The Commission considers that a more effective prudential and supervisory framework calibrated to the size and nature of investment firms may help to develop public capital markets by restoring the level playing field, boosting competition and improving investors' access to new opportunities and better ways of managing their risks.

Under the Mid-Term Review a legislative proposal to improve the proportionality of prudential rules for investment firms was adopted by the Commission in December 2017. In relation to this legislative proposal, the European Banking Authority («**EBA**») published a report in December 2015 in which it recommended, among other things, making a distinction between those investment firms for which the CRD IV and the CRR provide appropriate prudential requirements and the investment firms for which those

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[8] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of Credit institutions and the prudential supervision of Credit institutions and investment firms, and amending Directive 2002/87/EC and repealing Directives/48/EC and 2006/49/EC.

[9] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012.

requirements are not appropriate. It also proposed that a specific prudential regime should be designed for those investment firms for which the CRD IV and CRR would not be applicable. Following that report, in October 2016, the EBA recommended that investment firms to which CRD IV and CRR should apply are those identified as global systemically important institutions or other systemically important institutions («**Class 1**») (although the consideration of all other systemically important institutions as entities to which CRR and CRD IV should apply may be revised). In September 2017, the EBA recommended developing a consolidated single rulebook, separate from the one applied to credit institutions, for all MiFID investment firms not falling in Class 1.

2.4. INVESTING FOR THE LONG TERM, INFRASTRUCTURE AND SUSTAINABLE INVESTMENT

Institutional investors that have long-term liabilities are an important source of finance for long-term sustainable investments, such as those in infrastructure and green bonds. Given their long-term liability structure, the focus is primarily on insurance companies and pension funds' contribution to more long-term sustainable investments.

Feedback on the Green Paper demonstrated that some regulations needed to be revised. In relation to infrastructure investments, the Commission adopted legislation revising the Solvency II[10] calibrations to better reflect the risk of infrastructure investment. A review of the treatment of bank exposures to infrastructure under the CRR is ongoing. The Mid-Term Review calls for an assessment of the drivers of equity investments by insurance companies and pension funds, as well as an assessment on whether the accounting treatment of equity instruments in international accounting standards, in particular IFRS 9, is sufficiently conducive to long-term financing (as IFRS 9 may have an impact on long-term finance, including both investment and lending).

2.4.1. *SUPPORT INFRASTRUCTURE INVESTMENT*

Investments by insurers, which are large institutional investors, in infrastructure should be facilitated. Based on technical advice from the European Insurance and Occupational Pensions Authority («**EIOPA**»), the Commission adopted an amendment to the Solvency II Delegated Regulation[11] concerning infrastructure projects, which entered into force in April 2016[12], to ensure that insurance companies are subject to a regulatory treatment

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[10] Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance.

[11] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance.

[12] Commission Delegated Regulation (EU) 2016/467 of 30 September 2015 amending Commission Delegated Regulation (EU) 2015/35 concerning the calculation of regulatory capital requirements for several categories of assets held by insurance and reinsurance undertakings.

which better reflects the risk of infrastructure. This move was intended to address concerns that the absence of a distinct and suitably calibrated calculation of the regulatory capital that institutional investors should hold against infrastructure investments made such investments unattractive and hampered cross-border infrastructure investment.

The Commission noted that banks remain important in providing loans to infrastructure projects. In order to gain a better understanding of the impact of new regulatory capital requirements on the availability of financing for infrastructure and other investments that support long-term growth, the Commission published a consultation paper in July 2015 which included a review of banks' capital requirements for long-term and infrastructure finance. The Commission has proposed to lower credit risk capital requirements for banks' exposure to infrastructure as part of the CRR/CRD IV review in November 2016.

In order to further work towards the objective of the CMU, the Commission has made a proposal to amend the Solvency II Delegated Regulation, largely based on the technical advice received from EIOPA, which will provide appropriate risk calibrations for infrastructure corporates in all sectors, provided the investment meets prudent qualifying criteria.

2.4.2. *ENSURE CONSISTENCY OF THE EU FINANCIAL SERVICES RULEBOOK*

As already discussed, better regulation, the reduction of the administrative burden for market participants and the simplification of existing legislation will help the CMU deliver its potential. As part of its «better regulation» agenda, the Commission is pursuing an ambitious program to identify and remove unnecessary regulatory constraints.

The Commission launched a call for evidence to evaluate the interaction between rules and the cumulative impact and coherence of the financial reforms that have been introduced since the financial crisis. Based on the responses to the call for evidence and the discussions during the public hearing held in May 2016, the Commission issued a communication in November 2016 in which it stated that, overall, the financial services framework in the EU is working well and set out targeted follow-up actions in the following areas: (a) reducing unnecessary regulatory constraints on financing the economy, (b) enhancing the proportionality of rules without compromising prudential objectives, (c) reducing undue regulatory burdens and (d) making rules more consistent and forward-looking. Many of such actions have been integrated into existing reviews and legislative initiatives.

2.4.3. *SUPPORT SUSTAINABLE INVESTMENT*

Reforms for sustainable finance are necessary to support investment in clean technologies and their deployment, ensure that the financial system can finance growth in a sustainable manner over the long term and contribute to the creation of a low carbon, climate resilient economy.

The Commission established a High-Level Expert Group («**HLEG**») on Sustainable Finance in December 2016 whose objective was to help develop an overarching and comprehensive EU strategy on sustainable finance to integrate sustainability into EU financial

policy. The HLEG issued an interim report in July 2017 which identified two imperatives for Europe's financial system. The first is to strengthen financial stability and asset pricing, by improving the assessment and management of long-term material risks and intangible factors of value creation, including those related to environmental, social and governance («**ESG**») issues. The second is to improve the contribution of the financial sector to sustainable and inclusive growth, notably by financing long-term needs such as innovation and infrastructure and accelerating the shift to a low carbon and resource-efficient economy.

The HLEG will propose its final operational policy recommendations on the path towards an effective EU sustainable finance agenda by January 2018, at which time the Commission will have to decide on the concrete follow-up thereto.

2.4.4. *EXPAND OPPORTUNITIES FOR INSTITUTIONAL INVESTORS AND FUND MANAGERS*

Feedback on the Green Paper showed that prudential regulation was adversely affecting the appetite of institutional investors through the calibration of capital charges. In addition to the introduction of more risk-sensitive calibrations for infrastructure as described above, the future reviews of Solvency II will provide an opportunity to assess the long-term guarantees package in order to further explore incentives for long-term investment by insurers and to assess the appropriateness of the prudential treatment of private equity and privately-placed debt.

Feedback on the Green Paper also highlighted several barriers which are increasing costs for fund managers establishing funds and significantly impeding their ability to market cross-border. To rectify this, a consultation took place in 2016 on the main barriers to cross-border distribution of investment funds (UCITS and AIFs) in order to increase the proportion of funds marketed and sold across the EU. Responses identified a range of regulatory barriers that, alongside other reasons such as distribution models, national tax regimes and investor home-bias, cause market fragmentation.

In July 2016, an expert group on national barriers to the free movement of capital discussed barriers to the cross-border marketing of funds under AIFMD and the transparency of regulatory fees.

In June 2017, the Commission launched a public consultation on the inception impact assessment of its initiative to reduce barriers to the cross-border distribution of investment funds with a view to considering a possible legislative proposal to facilitate the cross-border distribution of UCITS and AIFs.

2.5. FOSTERING RETAIL AND INSTITUTIONAL INVESTMENT

The Commission considers that retail savings, held directly or through asset managers, life assurance companies and pension funds are key to unlocking Europe's capital markets. Feedback on the Green Paper revealed that more could be done to strengthen passporting and cross-border competition in the asset management industry. On the retail

side, action will be taken to boost choice and competition in cross-border retail financial services and to improve transparency and the quality of investment advice.

Action is planned to assist in saving for retirement. The Pan-European Personal Pensions Product («**PEPP**») is one of the key measures announced in the Mid-Term Review to increase choices for retirement saving and to build a Union market for personal private pensions. Increased transparency is also a key objective; in this regard, the Commission has asked the European Supervisory Authorities («**ESAs**») (which are the EBA, EIOPA and ESMA) to work on the transparency of long-term retail and pension products.

2.5.1. *INCREASED CHOICE AND COMPETITION FOR RETAIL INVESTORS*

Retail investor engagement is a critical challenge for the development of a stronger capital market in the EU. This requires greater confidence among retail investors and transparency to help investors to make the right investment decisions.

With the objective of increasing the level of retail investment in capital markets through competition, choice and cross-border supply, the Commission published a Green Paper consultation on Consumer Financial Services in December 2015.

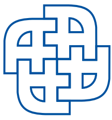
In March 2017, the Commission published an action plan setting out a strategy to strengthen the EU single market for retail financial services. The action plan identified three main strands of work with which to move closer to a single market for financial services: (i) increase consumer trust and empower consumers when buying services at home or from other Member States, (ii) reduce legal and regulatory obstacles affecting businesses when providing financial services abroad and (iii) support the development of an innovative digital world which can overcome some of the existing barriers to the single market.

In October 2017, the Commission issued a request to the ESAs to produce recurrent reports on the cost and past performance of the main categories of retail investment, insurance and pension products. This action will contribute to the objective set out in the 2015 Action Plan to foster the participation of retail investors in capital markets by supporting the assessment of the net return of retail investment products and the impact of diverse fees and charges.

2.5.2. *HELP RETAIL INVESTORS «GET A BETTER DEAL»*

Better information and advice are preconditions if retail investors are to be encouraged back into market-based financing. A first step is through transparency. In recent years, the EU has made significant progress in improving disclosure requirements across all sectors. New disclosure requirements have been introduced through different legislative measures. Legislation in MiFID II, Packaged Retail and Insurance-based Investment Products (PRIIPs)[13] and

[13] Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products.



Insurance Distribution Directive (IDD)[14] brings in important changes to the rules governing investment advice and product disclosure. The transition to the online distribution of investment products and the emergence of new Fintech solutions present an opportunity to develop further advisory services and «open access» to online distribution platforms. It will be important to ensure these changes are accompanied by a critical assessment of the investment solutions and outcomes that are proposed to retail investors.

In December 2016, the Commission launched a comprehensive assessment of European markets for retail investment products, including distribution channels and investment advice. Results of the study were expected by the end of 2017.

Transparency may need to be underpinned by market infrastructure or systems to ensure that mandated disclosures can be used by intermediaries and investors to make an informed product selection and direct investment flows to lowest-cost/highest net return solutions. As a follow-up action, the Commission is considering to launch a feasibility study on the development of a centralised hub for mandatory disclosure requirements and related services.

Taking into account the complexity of financial education, some policies can stimulate investors to increase their financial literacy. For example, the experience in some Member States has shown that investment savings accounts can contribute to a high level of retail investor engagement with capital market products, via easier access to investment products such as equities, corporate bonds and investment funds.

2.5.3. *SUPPORT SAVING FOR RETIREMENT*

The Commission will consider proposals for a simple, efficient and competitive EU personal pension product («**PPP**»). Personal pensions have an important role to play in linking long-term savers with long-term investment opportunities. Personal pensions can help address the demographic challenges of aging populations and evolving working patterns among the workforce, and help to secure adequate replacement rates in the future as a complement to state-based or occupational pensions.

In July 2016, EIOPA provided final advice on the development of an EU Single Market for PPPs, which primarily assesses opportunities to improve the current personal pensions market through a PEPP (defined above). EIOPA confirmed its views that a standardised PEPP with a defined set of regulated, flexible elements would be best placed to support sustainable pensions via personal pension savings that are safe, cost-effective, transparent and sufficiently flexible to accommodate the current economic and labour market environment in Europe and to promote a Single Market for personal pensions.

In July 2016, the Commission launched a public consultation on a potential EU personal pension framework, which closed on 31 October 2016. The objective of the public

[14] Directive 2016/97/EC of the European Parliament and of the Council of 10 January 2016 on insurance distribution.

consultation was to identify potential obstacles to the uptake of PPPs and to seek views on how to best address them.

In September 2016, the Commission launched a study on the tax aspects of personal pensions. The study aims to map the tax regimes applicable to personal pension products within the EU Member States.

In June 2017, the Commission launched a new pan-European personal pensions label to help consumers save for retirement. The proposal will provide pension providers with the tools to offer a simple and innovative PEPP. This new type of voluntary personal pension is intended to give savers more choice when they are putting money aside for old age and provide them with more competitive products. PEPPs will have the same standard features wherever they are sold in the EU and can be offered by a broad range of providers, such as insurance companies, banks, occupational pension funds, investment firms and asset managers. They will complement existing state-based, occupational and national personal pensions. The Commission recommends that Member States grant the same tax treatment to this product as to similar existing national products. PEPPs will also ultimately bolster the Commission's plan for a CMU by helping to channel more savings to long-term investments in the EU.

2.6. LEVERAGING BANKING CAPACITY TO SUPPORT THE WIDER ECONOMY

The fifth of the priority areas identified in the 2015 Action Plan was the need to leverage banking capacity to support the economy. The Commission recognised the importance of banks in the development of the CMU since they are a key source of funding for a large part of the economy and play a significant role as intermediaries in the capital markets.

2.6.1. *STRENGTHENING OF LOCAL FINANCING NETWORKS*

The 2015 Action Plan considered that strong local networks are important in supporting growth. Indeed, in a number of EU Member States, credit unions, cooperatives and similar types of lenders play a key role in financing smaller companies, which are a driver for growth and employment. Some of these types of lenders provide financing to their members on a not-for-profit basis and even support their business further (for instance, by facilitating the exchange of know-how).

The Commission concluded that the application of complex banking rules could be a disproportionate obstacle to such lenders. In some Member States, such as Ireland and the United Kingdom, these types of lenders are already not subject to the EU's capital requirements for banks (basically set out in CRR and CRD IV). In order to ensure a level playing field, the Commission proposed the need to explore the possibility for all Member States to benefit from lenders of this type which are not subject to complex capital requirements but are yet subject to requirements commensurate to the risks they entail.

The first status report of the CMU published by the Commission on April 2016 indicated this objective would require amendments to the current capital requirements regime set out in CRR and CRD IV. In November 2016, the Commission published a proposal to amend the CRR-CRD IV framework in order to facilitate the exemption from such framework of institutions that are similar to the ones already exempted from it. To that end, it proposed that the Commission should be allowed to exempt specific institutions or categories of institutions from the CRR-CRD IV framework, provided that they comply with certain defined criteria. As of December 2017, the proposal is with the Council for its review.

2.6.2. *REVIVAL OF EU SECURITISATION MARKETS*

One of the key pillars of the CMU and one where progress to date has been significant is the need to revive the EU securitisation markets.

2.6.2.1. Introduction to securitisation

Securitisation is a financing technique which originated in the United States in the 1970s and has become an undoubtedly significant instrument in financial markets. According to data provided by the Association for Financial Markets in Europe, in 2006, the United States reached an issue volume of securitisation bonds exceeding 2,400 billion euros. Even in Europe, a region traditionally much more dependent on bank financing, issues surpassed 800 billion euros in 2008 (with Spain being one of the main issuers of these types of securities in Europe in the years leading up to the financial crisis). However, these issue levels have decreased in recent years as a result of the crisis.

From an economic-financial perspective, securitisation is a financing technique consisting of incorporating certain credit rights into an issue of negotiable securities, in such a way that the debt service (i.e. the payments of principal and interest) is mainly covered by the cash flow generated by those credit rights.

The essence of securitisation lies in incorporating the securitised assets into an issue of securities, so that: (a) the holders of such securities only have recourse to the payment of those securities using the incorporated assets, excluding any others that may potentially be held by their assignor (called the «originator») and (b) only the holders of such securities have access to the rights incorporated in them, with this possibility being denied to any other of the originator's creditors.

The foregoing is generally implemented legally, notwithstanding the existence of other possible methods, by means of the assignment by the originator or assignor of the assets in question (known as a «true sale») to an entity created *ad hoc* and lacking any other assets (with limited exceptions) and the issue by the latter of securities, the product of which (i.e. the subscription price) is used to pay to the originator the purchase price of the securitised assets. This entity created to implement the securitisation process is known indistinctly, in light of the main functions entrusted to it in such process, as the

«assignee» or «issuer». Throughout the lifetime of the transaction, the income from the securitised assets is allocated to pay the interest and repay the principal of the securitisation bonds issued.

Securitisation is a process which can be used to achieve a series of objectives, both direct and indirect. In short, securitisation allows originator entities to obtain financing without increasing their indebtedness, by efficiently redistributing the risk (of the originator entity to the entities subscribing the bonds issued by the issuer), thereby giving investors access to a series of financial investment instruments suited to their risk/return profile, while lightening their balance sheet –in the case of the banks– and thus helping to increase the capital available to finance companies and indirectly creating employment and wealth.

Precisely that capability securitisation has of redistributing risks led to negligent practices in some entities which had focused their business model on the disproportionate origination of financing operations without having carried out proper credit analyses, in light of the ease of spreading the portfolio's credit risk by securitising it (the so-called «originate to distribute» model).

Today, securitisation has not yet managed to shake off the stigma of the financial crisis and this, together with the burdensome regulation in place, the current abundance of liquidity in the markets and historically low interest rates (making simpler sources of financing more accessible), have forestalled a full resurgence of securitisation in Europe.

However, both the market and the authorities show a growing interest in reviving the securitisation market, as the many recent publications, studies and queries on this confirm. The common theory underlying these initiatives is that, in the current context of seeking to reduce bank financing, simple, clear and standardised securitisations may serve as a channel for diversifying the sources of financing, redistributing risks more efficiently in the financial system and lightening banks' balance sheet, thereby permitting them to increase their capacity to finance the real economy and ultimately create jobs and wealth.

In line with the foregoing, the 2015 Action Plan considered that securitisation could increase the availability of credit, reduce the cost of funding, contribute to a well-diversified funding base and act as an important risk-transfer tool to improve capital efficiency and allocate risk to match demand. The Commission indicated that whilst there was no intention to undo EU reforms addressing the risks inherent in highly complex and opaque securitisations, reforms should be put forward to better differentiate simple, transparent and standardised (STS) products to support investor confidence and reduce due diligence burdens.

2.6.2.2. EU Securitisation Regulation

At the time the 2015 Action Plan was published, the Commission also published a proposal for an EU framework for simple, transparent and standardised (STS) securitisation, together with new prudential calibrations for banks and investment firms in CRR to properly reflect the specific features of STS securitisations. Equivalent calibrations for

insurers, through an amendment to the Solvency II Delegated Regulation to incorporate the STS criteria are expected to follow, as soon as the STS framework has been adopted. The measures would help banks to free up the capital they set aside to cover the risks of the securitised exposures, allowing them to generate new lending. STS securitisations will also provide new investment opportunities for institutional investors such as pension funds and insurance companies.

According to the Commission's estimates at the time, if EU securitisation issuance were built up again to the pre-crisis average, it would generate up to 150 billion euros in additional funding for the economy.

The Commission proposal concerning the identification of the STS criteria and the capital treatment of securitisation exposures of banks and investment firms takes into account the conclusions of the EBA report on a framework for qualifying securitisation dated July 2015. It also reflects on work carried out on a global level by the Basel Committee on Banking Supervision (BCBS) and the International Organisation of Securities Commissions (IOSCO).

In May 2017, the European Parliament, the Council and the Commission reached political agreement on the text of the proposed Securitisation Regulation and the final vote took place at the EU Parliament at the end of October 2017. The final publication of the Regulation in the Official Journal of the EU took place on 28 December 2017.

The Securitisation Regulation has introduced changes in relation to the following aspects: (i) it replaces all of the existing sectoral legislation relating to due diligence and risk retention by a new uniform regime applying to all «institutional investors», (ii) it imposes EU originators, sponsors and original lenders a direct obligation to retain a 5% net economic interest in the transaction (in addition to the obligation on EU investors to check, as part of their regulatory due diligence, that the retention obligation is being met), (iii) it enhances transparency requirements and (iv) it introduces the concept of «simple, transparent and standardised» or «STS» securitisation, so that transactions meeting criteria for simplicity, transparency and standardisation can be marked for more benign regulatory treatment. It is clear that part of this more benign regulatory treatment is some regulatory capital relief for bank investors in securitisation.

2.6.3. *CREATION OF AN EU COVERED BOND INSTRUMENT FOR SME LOANS*

Covered bonds are another funding tool of particular importance in some Member States. Covered bonds are debt obligations issued by credit institutions and secured on the back of a ring-fenced pool of assets referred to as «cover pool». Bondholders have direct recourse to the cover pool as preferred creditors, while remaining entitled to claim against the issuing entity or an affiliated entity of the issuer, as ordinary creditors, for any residual amounts not fully settled with the liquidation of the cover pool. The issuer is normally under the obligation to ensure that the value of the assets in the cover pool at least matches at all times the value of the covered bonds and to replace assets that become non-performing or, otherwise, stop meeting relevant eligibility criteria. The

cover pool comprises high quality assets, typically, but not exclusively, mortgage loans and public sector debt.

Covered bonds have proved to be a successful countercyclical source of funding during the crisis. This notwithstanding, the covered bond market is fragmented across the EU. The disparity between the legal frameworks of the Member States limits the possibilities for market standardisation which may result in obstacles to market depth, liquidity and investor access, in particular on a cross-border basis. In 2015, the Commission considered that an EU framework for a more integrated covered bond market could help reduce the cost of funding for banks issuing covered bonds and launched a consultation on the development of a pan-European framework for covered bonds. The consultation also sought views on the use of similar structures to support SME loans.

Respondents to the consultation did not generally regard an absence of EU-level harmonisation as the most significant factor causing market fragmentation. While respondents were concerned that harmonisation could risk impairing well-functioning markets and reduce product offering, at the same time they showed cautious support for EU targeted action, which should in any event respect the unique characteristics of national frameworks. Respondents also noted that market fragmentation will continue because of the strong link between the credit performance of the cover pool and the macro-economic performance of the country in which the issuer is located and the credit rating of the sovereign.

In light of the foregoing, the Mid-term Review has identified the following actions for 2018: (i) produce a legislative proposal for an EU framework on covered bonds in order to create a more integrated covered bond market in the EU without undermining the quality of existing covered bonds and (ii) assess the case for developing European Secured Notes («**ESNs**») for SME loans and infrastructure loans, a market-led initiative by the European Covered Bond Council (ECBC) to create a dual recourse instrument on the back of loans to SMEs and infrastructure loans. The ESN asset class aims to cover a funding segment located between traditional covered bonds and STS securitisations.

In relation to the second of the actions above, the Commission has recently issued a call for advice to the EBA concerning ESNs. The Commission is asking for advice on: (i) the extent to which best practices for covered bonds could be applicable on a *mutatis mutandis* basis to ESNs, (ii) the appropriate risk treatment of ESNs in light of their features and expected risk-return profile and (iii) the effects ESNs could have on individual banks in terms of asset encumbrance impact on unsecured bank creditors. The Commission has requested a final report from the EBA by 30 April 2018, to allow it to complete its assessment of the case for ESNs by the second quarter of 2018.

2.6.4. *STRENGTHENING SECONDARY MARKETS FOR NPLS*

The Mid-term Review has indicated that capital markets can also help European banks to overcome the challenges of non-performing loans («**NPLs**») which are weighing heavily on some national banking systems. NPLs have a significant adverse impact on banks' profitability and their ability to lend.

The Commission believes a solution could be to improve the functioning of secondary markets for NPLs to increase transparency and allow purchasers to more accurately price those assets. In light of this, the Commission has indicated that it will launch a public consultation on potential EU action in areas such as loan servicing by third parties and the transfer of loans.

The management of NPLs would also benefit from more efficient and more predictable loan enforcement and insolvency frameworks designed to enable swift value recovery by secured creditors and, in this regard, a benchmarking exercise is underway and is expected to be completed in the first quarter of 2018, with a view to considering a possible legislative initiative to strengthen the ability of secured creditors to recover value from secured loans.

2.7. FACILITATING CROSS-BORDER INVESTING

In the 2015 Action Plan the Commission noted that, despite progress towards developing a single market for capital, there were still many barriers to cross-border investment, often with their origins in local insolvency, tax and securities law. The Commission stated its intention to tackle these in a number of ways, including by consulting on the key insolvency barriers to cross-border investment with a view to proposing a legislative initiative on business insolvency and tackling uncertainty around securities ownership.

In addition, as described under *Expand opportunities for institutional investors and fund managers* above, the Commission is also considering a legislative proposal to improve the cross-border distribution of AIFs and UCITs, as well as their supervision. Further measures are also being taken in fields such as tax and corporate governance. In connection with the latter, the Commission intends to facilitate the cross-border exercise of shareholder rights, including voting, in the implementation of the Shareholders Right 2 Directive[15] published on 20 May 2017.

With respect to the regulatory environment, the Commission stated its intention to work with the ESAs to develop a strategy to strengthen supervisory convergence and to monitor the risks to financial stability that could potentially arise from market-based financing. Strengthening the powers of the ESAs is the first priority measure set out in the Mid-Term Review.

2.7.1. *REMOVE NATIONAL BARRIERS TO CROSS-BORDER INVESTMENT*

The success of the CMU can only be ensured if Member States are determined to work to dismantle the unjustified national barriers to the free movement of capital. National provisions often go beyond EU law and can in some instances be damaging to cross-border investment.

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[15] Directive (EU) 2017/828 of the European Parliament and of the Council of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement.

The Commission and an expert group of Member States' representatives have been working together, with the European Parliament as observer, to map national barriers to cross-border capital flows and find the best ways of tackling those that are either not justified by public interest considerations or are disproportionate.

In March 2017, the Commission issued the report addressing national barriers to capital flows.

The report distinguishes between *ex ante* barriers (of immediate concern when investors consider engaging in cross-border activity), *in itinere* barriers (deterring investors from maintaining or increasing their cross-border exposure) and *ex post* barriers (leading to difficulties at the end of the investment process). The report builds on the discussions in the expert group and proposes next steps, without necessarily reflecting a consensus between the Member States on each subject. The Commission expects Member States to agree on the proposed roadmap and take action accordingly.

Ex ante barriers include: (i) barriers to the cross-border distribution of investment funds including marketing requirements (as wide disparities in national rules and divergent supervisory approaches are a significant impediment to a fully-effective EU passport in the asset management sector), administrative arrangements (due to diverging domestic administrative arrangements imposed by host Member States) and regulatory fees for marketing cross-border (as the range of regulatory fees charged by host Member States and the lack of transparency hinder the development of the cross-border marketing of funds across the EU), (ii) requirements on investment by pension funds (as many Member States apply limits on investments in various asset classes) and (iii) different national approaches to crowdfunding (as consumer or investor protection rules, among other factors, may lead many platforms to refuse to provide their services to non-residents).

In itinere barriers include: (i) residence and location requirements imposed on the managers of financial market players and (ii) insufficient financial literacy, which may prevent consumers and SMEs from accessing capital markets.

Ex post barriers include: (i) differences in national insolvency regimes, which generate legal uncertainty and (ii) discriminatory and burdensome procedures for withholding tax relief, as some cross-border investments are taxed both in the country that is the source of the securities' income and in the investor's country of residence, which have a negative effect.

The Commission will monitor the implementation of the roadmap on removing national barriers to free movement of capital and continue discussions with the expert group.

2.7.2. *IMPROVE MARKET INFRASTRUCTURE FOR CROSS-BORDER INVESTING*

The Commission intends to take steps to alleviate the uncertainty surrounding securities ownership –in particular in cross-border situations– and in this regard, it plans to enhance and broaden existing rules in the field. This is to address the concerns of many

respondents to the Green Paper who called for rules to clarify which national law applies to any given cross-border securities transaction. Uncertainty over which law applies in the event of legal challenges on ownership in chain transactions involving different EU countries gives rise to costs and risk. The Mid-Term Review also includes a legislative proposal specifying conflict of laws rules for third-party effects of transactions in securities and claims, as a follow up action.

Efficient and safe post-trade infrastructures are key elements of well-functioning capital markets. The Commission is reviewing progress in removing Giovannini barriers[16] to cross border clearing and settlement, taking into consideration recent legislation such as EMIR, CSDR and MiFID2. This is to address concerns that, despite the progress that has been made in recent years, barriers remain to efficient cross-border clearing and settlement because of uncertainty as to who owns a security in the event of a default and whose rights take precedence in the event of insolvency. Uncertainty on such fundamental issues poses important legal risks, for example to the enforceability of collateral, and can threaten the resilience of cross-border settlement and collateral flows.

In early 2016 an informal expert group on post-trading, including the areas of collateral markets and derivatives, the European Post Trade Forum («**EPTF**»), was set up to assist the Commission in undertaking the above review. The work of the EPTF has proceeded in two distinct phases: the first phase, during which the EPTF undertook and analysis of post-trade market practices as well as legislative and market trends and the second phase, during which the EPTF assessed the extent to which the Giovannini barriers have been removed and identified current barriers and bottlenecks. The report prepared by the EPTF was published in August 2017. The major unresolved issues measured in the context of the CMU against the objective of an integrated, safe and efficient post-trade system in Europe which should obtain, in the view of EPTF members, the highest priority to be resolved and dismantled are the following: (i) inefficient withholding tax recovery procedures, (ii) legal inconsistencies and uncertainties, (iii) fragmented corporate actions and general meeting processes, (iv) inconsistent application of asset segregation rules, (v) lack of harmonisation in registration and investor identification rules and processes and (vi) complexity of post-trade reporting structure.

Simultaneously to the publication of the EPTF report, the Commission launched a public consultation on how to improve post-trade services used in financial transactions, including clearing, settlement and collateral management. The results of the consultation will feed into future legislative reviews.

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[16] The Giovannini group was a group of financial market experts, formed in 1996 to advise the Commission on financial market issues. In particular, the work of the Giovannini group focused on identifying inefficiencies in EU financial markets and proposing practical solutions to improve market integration.

The Giovannini group's two reports identified a total of 15 specific barriers that prevent efficient EU cross-border clearing and settlement.

2.7.3. *FOSTER CONVERGENCE OF INSOLVENCY PROCEEDINGS*

The 2015 Action Plan announced a legislative initiative on business insolvency, including early restructuring and second chance. Inefficiencies and differences in national insolvency frameworks generate legal uncertainty, obstacles to recovery of value by creditors and barriers to the efficient restructuring of viable companies in the EU, including for cross-border groups.

In November 2016, the Commission presented a proposal for a Directive on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.

The aim of the proposal is for all Member States to have in place key principles on effective preventive restructuring and second chance frameworks and measures to make all types of insolvency procedures more efficient by reducing their length and associated costs and improving their quality. More specifically, such frameworks aim to help increase investment and job opportunities in the single market, reduce unnecessary liquidations of viable companies, avoid unnecessary job losses, prevent the build-up of non-performing loans, facilitate cross-border restructurings and reduce costs and increase opportunities for honest entrepreneurs to be given a fresh start.

2.7.4. *REMOVE CROSS-BORDER TAX BARRIERS*

Taxation regimes can present barriers to the development of cross-border capital markets. To avoid double taxation of cross-border investment, most bilateral tax treaties provide for withholding refunds. In practice, however, investors face complex, demanding, resource-intensive and costly procedures. Tackling burdensome withholding refund procedures is all the more urgent, as they affect all kinds of financial instruments (bonds, shares and derivatives) and stakeholders. The Commission intends to issue best practice and develop a code of conduct, in conjunction with Member States, on withholding tax relief principles, to encourage Member States to adopt systems of relief at source.

The Commission has also undertaken a study on discriminatory tax obstacles to cross-border investment by funds and life insurance companies and, where necessary, will initiate infringement procedures.

2.7.5. *STRENGTHEN SUPERVISORY CONVERGENCE AND CAPITAL MARKET CAPACITY BUILDING*

Effective and consistent supervision is essential to ensure investor protection, promote the integration of capital markets and safeguard financial stability. Capital markets legislation adopted in recent years confers an important role on the ESAs in a number of areas. Since their establishment, the ESAs have contributed to the building of the single rulebook for financial services (banking, insurance and capital markets) and to the convergence of supervisory practices.

ESMA in particular plays a key role in fostering capital market integration. In this regard, there is a need to strengthen ESMA's ability to identify and tackle weaknesses in national supervision and to identify areas where ESMA's direct supervision may be warranted. On 9 February 2017, EMA published its 2017 Supervisory Convergence Work Programme, which details the activities and tasks it will carry out to promote sound, efficient and consistent supervision across the EU.

ESMA and national competent authorities («**NCAs**») will focus their supervisory convergence work on the following priorities: (i) the implementation of MiFID II/MiFIR and Market Abuse Regulations (MAR), including the underlying IT projects, (ii) improving the quality of data collected by NCAs, (iii) investor protection in the context of cross-border provision of services and (iv) convergence in the supervision of EU Central Counterparties (CCPs).

In March 2017 the Commission launched a public consultation on the operations of the ESAs. Stakeholder feedback pointed to the need to adjust the regulatory framework under which the ESAs operate, so as to improve their ability to supervise the financial sector and thus to better deliver on their objective.

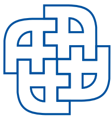
In September 2017 the Commission proposed certain reforms to improve the mandates, governance and funding of the ESAs. The proposals also entrust ESMA with direct supervisory power in specific financial sectors to ensure a uniform application of EU rules and promote a true CMU. In particular, ESMA will: (i) supervise benchmarks that are deemed to be critical (such as EURIBOR and EONIA) and also endorse all non-EU benchmarks used in the EU, (ii) be in charge of approving certain EU prospectuses and all non-EU prospectuses drawn up under EU rules, (iii) authorise and supervise certain investment funds with an EU label, with the aim of creating a genuine single market for these funds and (iv) have a greater coordinating role in market abuse cases. In addition, the Commission is proposing targeted changes to the composition and organisation of the European Systemic Risk Board («**ESRB**»), which monitors stability risks for the financial system as a whole.

Greater clarity on existing substantive EU standards is important for EU investors, national administrations, stakeholders as well as for national court judges. In the first quarter of 2018, the Commission will adopt an interpretative communication to provide guidance on existing EU rules for the treatment of cross-border EU investments. It will also launch an impact assessment with a view to setting out an adequate framework for the amicable resolution of investment disputes.

2.7.6. *ENHANCE CAPACITY TO PRESERVE FINANCIAL STABILITY*

Following the financial crisis, the EU set up the European System of Financial Supervision («**ESFS**»), built on a two-pillar system of macro-prudential and micro-prudential supervision.

The ESRB is the macro-prudential pillar of the ESFS. The ESRB is responsible for macro-prudential oversight of the financial system in the EU. Its tasks include: (i) contributing to the prevention or mitigation of systemic risks to financial stability in the EU



that arise within the financial system, while taking into account macroeconomic developments, so as to avoid periods of widespread financial distress and (ii) contributing to the smooth functioning of the internal market, ensuring that the financial sector has a sustainable contribution to economic growth. The ESRB has broad membership including national central banks, supervisors and European institutions. It has specific tools, such as recommendations and warnings to shape macro-prudential policy in the EU. The ESRB has a direct effect on the effectiveness of EU countries' macro-prudential measures and in turn on the degree of financial stability in the EU.

In August 2016 the Commission launched a public consultation to gather feedback and evidence on the functioning of the EU macro-prudential framework. Stakeholders generally considered the ESRB's mandate and tasks appropriate to ensure the efficiency and effectiveness of macro-prudential policies and expressed some support for adjusting the ESRB's working practices to make it more efficient.

In September 2017 the Commission submitted a proposal for a Regulation amending Regulation (EU) No 1092/2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board. Improvements to the ESRB's composition and how it cooperates with European institutions are needed to take account of incremental changes to the macro-prudential framework and the waves of regulatory developments that have taken place. In addition, changes are needed to ensure that the ESRB is able to perform macro-prudential oversight of the entire financial system as the importance of market-based financing increases, particularly with the establishment of the CMU.

2.8. STRENGTHENING THE CAPACITY OF EU CAPITAL MARKETS

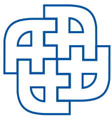
This building block was not part of the original 2015 Action Plan. It was introduced in the Mid-Term Review. It includes two priority actions:

2.8.1. *SUPERVISION*

As explained under *Strengthen supervisory convergence and capital market capacity building* above, effective and consistent supervision is essential to ensure investor protection, promote the integration of capital markets and safeguard financial stability. For that reason, in September 2017 the Commission adopted a package of proposals to strengthen the ESFS, with the aim to improve the mandates, governance and funding of the three ESAs and the functioning of the ESRB.

2.8.2. *DEVELOP LOCAL AND REGIONAL CAPITAL MARKETS*

For market-based finance to be a viable and sustainable alternative to bank lending, the CMU needs to build the financial circuits, market conventions and technical and legal infrastructure. The maturity of capital markets differs considerably depending on



the country in question. The Commission attaches great importance to the promotion of local and regional capital markets, particularly in the central, eastern and south-eastern regions of Europe. To that end, it will present a comprehensive strategy in the second quarter of 2018.

A key work stream for achieving these objectives is the provision of technical support to Member States through the Structural Reform Support Programme (the «**Programme**»), which has been established in 2017 with the objective of strengthening the capacity of Member States to prepare and implement growth-enhancing administrative and structural reforms by providing support to national authorities. Under the Programme, the Commission has received over fifty requests for technical support in the financial sector from thirteen Member States, with a high focus on support for the development of capital markets.