European Commisssion Communication on the Capital Markets Union Mid-term review

In September 2015, the European Commission launched its **Capital Markets Union (CMU) Action Plan** to boost jobs and growth in the EU. Two years on, in January, the Commission held its scheduled public consultation based on the mid-term review of the Plan. The consultation closed on 17 March having garnered 178 responses.

It had three aims: a) **to take stock of progress** on implementation, b) **to reframe actions in light of work done** so far and changes to markets, c) to **complement the Plan with new measures** that delivered an effective and proportional response to current challenges.

As a result, on 8 June the Commission published a Communication restating its commitment to CMU and setting out nine new priority measures intended to: a) simplify cross-border investment and develop capital markets throughout the EU and, b) address some additional key issues in developing a more integrated EU capital market system by 2019.

Financial markets are increasingly interconnected within the EU and globally. This **demands further integration of EU supervision to meet future challenges.** Effective international cooperation will also require a strengthened supervisory framework to provide equivalence. All of which, coupled with recent political and economic events in the EU, particularly Brexit, makes the review of the CMU Action Plan more relevant and more timely now than ever.

In its review, the Commission identified a number of points for urgent inclusion in the Plan, as follows:

First, the **supervisory framework i**s a necessary element for well-functioning and integrated capital markets. Financial entities with similar business size and risk profiles should be subject to the same standard of supervision anywhere in the EU to avoid regulatory arbitrage.

Meanwhile, **financial technology (FinTech)** is transforming capital markets by bringing new market players and more efficient solutions, increasing competition, and lowering costs for businesses and investors.

Another key factor that needs to be integrated into financial markets is **sustainability.** There is a need to mobilise and orient more private capital flows towards economically, socially and environmentally sustainable investments.

Institutional investors have traditionally acted as long-term equity investors. However, in the last 15 years insurance companies in the EU have been cutting back their exposure to these securities. Pension funds, while maintaining a stronger long-term equity presence, tend to invest the bulk of their assets either in their home market or outside the euro zone. There is a need to assess the economic drivers of equity investments by both groups and the potential impact of regulatory constraints and other factors at EU and national level.

Finally, there is a need to **broaden the geographical reach of capital markets** so that all member states can reap the benefits of deeper and more integrated markets.

The Commission proposes to address these issues through the following measures:

1. Strengthen the effectiveness of supervision to accelerate market integration.

To ensure a Europe-wide approach to supervision and consistent application of the single rule book it is essential to strengthen the powers and tools available to the European Securities and Markets Association (ESMA) to uncover and address weaknesses identified at national level and to identify areas where ESMA needs to exercise direct supervision.

The challenges arising in relation to CCPs are particularly noteworthy, given their growing systemic importance for the EU financial system – due to their size and interconnectedness – and the identified shortcomings of current

arrangements between EU and third-country CCPs.

To achieve this, following consultation, the Commission's **first priority action will be to propose, during the third quarter 2017, amendments to the functioning of ESMA and the other ESAs to promote the effectiveness of consistent supervision across the EU.** Also in targeted areas, the Commission will strengthen ESMA's powers including, where warranted, granting more powers of direct supervision to support the proper functioning of CMU.

2. Enhance the proportionality of rules to support initial public offerings and investment firms

The amount of equity raised on markets for growth companies has decreased by EUR 9 billion in recent years compared to pre-crisis levels. Much needs to be done to help IPOs by SMEs in EU markets.

The Commission has been working since 2016 with representatives of public markets and other partners to assess how these markets are functioning in the EU and identify potential solutions to eliminate current barriers.

To take this matter forward, the Commission's **second priority action is to explore through an impact assessment whether targeted amendments to relevant EU legislation could deliver a more proportionate regulatory environment to support SME listing on public markets,** which could lead to targeted changes in the second quarter 2018.

Regarding investment firms, a supervisory framework calibrated to their size and nature in its prudential demands should restore the level playing field, boost competition and improve investors' access to new opportunities and better ways of managing their risks.

This leads to the Commission's **third priority action, to present a legislative proposal to review the prudential treatment of investment firms in the final quarter of 2017.**

3. Harness the potential of financial innovation or FinTech.

The Commission is assessing various initiatives by which FinTech firms can contribute to deepening and broadening EU capital markets. Digitisation has massive potential to change current business models, introducing innovative solutions on asset management, investment intermediation and product distribution.

On 23 March, the Commission launched a consultation on FinTech expected to collect valuable information on whether new, more proportionate licensing arrangements are needed for FinTech activities and firms in areas such as investment-based and lending-based crowdfunding and how FinTech firms registered in one EU country might do cross-border business without having to apply for a separate licence from each EU country (passporting).

This leads to the Commission's **fourth priority action, to assess the case for an EU licensing and passporting framework for FinTech activities** in the fourth quarter 2017.

4. Using capital markets to strengthen bank lending and stability.

The biggest challenge to overcome on this front is non-performing loans (NPLs), which are weighing heavily on some traditional banking systems and having a significant adverse impact on banks' profitability and their ability to lend, including to SMEs.

The Commission's initiatives to address this issue include, as its **fifth priority action, measures to support the development of secondary markets for non-performing loans. It will also launch an impact assessment in the first quarter 2018 on possible legislative initiatives to strengthen the ability of secured creditors to recover value from secured loans to corporates and entrepreneurs.**

5. Strengthen the EU's leadership on sustainable investment.

The UN Agenda for Sustainable Development and the Paris agreement make it clear that reform of the financial system is central to putting our economies on a sustainable growth path.

On this point, the Commission's **sixth identified action priority is to set, during the first quarter 2018, a concrete follow-up to the recommendations of the High Level Expert Group (HLEG) on Sustainable Finance** on how to integrate sustainability considerations with financial regulation and the practices of financial markets in the EU.

The Commission will also set in motion work to prepare measures to improve disclosure and better integrate

sustainability in rating methodologies and supervisory processes, as well as in the investment mandates of institutional investors and asset managers. It will also develop an approach for taking sustainability considerations into account in upcoming legislative reviews of financial legislation.

6. Cross-border investment.

Investment funds in the EU are still small and less cost-efficient than in some other jurisdictions and distribution remains geographically limited. Greater cross-border distribution and in particular digital cross-border distribution would allow funds to grow, allocate capital more efficiently across the EU and foment competition within national markets.

Accordingly, the Commission's **seventh priority action is to launch an impact assessment in the first quarter 2018 with a view to considering a possible legislative proposal to facilitate the cross-border distribution and supervision of UCITS and AIFs.**

A stable investment environment is also crucial to promoting greater investment in the EU. Greater clarity on existing substantive EU standards is particularly important for investors, national administrations, stakeholders and national courts. The situation is complicated by bilateral investment treaties between member states which set varying standards of treatment for cross-border investment within the single market and which are outside the EU legal framework and incompatible with EU law.

All of which underlies the Commission's **eighth priority action, to adopt** in the first quarter 2018 **an interpretative Communication to provide guidance on existing EU rules for the treatment of cross-border EU investments.** It will also immediately launch an impact assessment to set out an adequate framework for the amicable resolution of investment disputes.

7. Support the development of local capital market ecosystems.

As its **ninth priority action, in the second quarter 2018 the Commission will propose a comprehensive EU strategy on steps that can be taken at EU level to support local and regional capital market development across the EU,** taking account of experience gained from the growth in demand for technical support under the EU Structural Reform Support Programme.

Links:

Action Plan on Building a Capital Markets Union

Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions on the Mid-Term Review of the Capital Markets Union Action Plan.

Public consultation on the operations of the European Supervisory Authorities

Consultation Document. FinTech: A more competitive and innovative European Financial Sector.

United Nations. Sustainable Development Goals. 17 goals to transform the world