EU Communication

ACTION PLAN ON CAPITAL MARKETS UNION

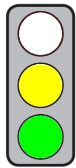
cep**PolicyBrief** No. 2016-01

cep Centrum für Europäische Politik

KEY ISSUES

Objective of the Communication: The Commission presents concrete measures with which it wants to establish the Capital Markets Union by 2019.

Affected parties: All capital market players, particularly banks, insurance companies, businesses.



Pro: (1) Removing obstacles to the free movement of capital across borders increases efficiency, strengthens competition and boosts the potential for growth.

(2) EU rules on whether and under what conditions investment funds can issue loans, make regulatory arbitrage between investment funds and banks more difficult.

(3) A label for "simple, transparent and standardised" securitisations may increase confidence in the securitisation markets.

Contra: Promoting infrastructure investment by lowering the capital requirements for insurance companies and banks is risky.

CONTENT

Title

Communication COM(2015) 468 of 30 September 2015: **Action Plan on Building a Capital Markets Union**

Brief Summary

- **Context and objectives**
  - According to the Commission, Europe's capital markets are "underdeveloped and fragmented". Thus Europe's equity markets are less than half the size of those of the US, its debt markets less than a third the size. (p. 3)
  - The aim of Capital Markets Union is (p. 3),
    - to increase investment and growth in the EU and
    - to further integrate and - particularly in the eurozone - stabilise the financial system.
  - In this Action Plan, the Commission sets out building blocks containing the individual measures for achieving a "well-functioning and integrated Capital Markets Union".

- **Building Block 1: Promoting "non-bank" financing options**

  Regulating crowdfunding
  - Recently, in addition to other new "non-bank" financing options, crowdfunding has seen rapid development; it involves a public request, generally made over the internet, for the provision of funds for specific projects [Communication COM(2014) 172, see cep**PolicyBrief**].
  - The Commission will submit a report on the European crowdfunding market and the national regulations relating thereto in the 1st quarter of 2016. It wants to avoid "premature regulation". (p. 7)

  Marketing of venture capital
  - According to the Commission, EU venture capital funds are, on average, only half the size of those in the US. In addition, approx. 90% of the investment from these funds is concentrated in "only 8 Member States". (p. 8)
  - The Regulations on the EU Venture Capital Fund [EuVECA Regulation, (EU) No. 345/2013] and the EU Social Entrepreneurship Fund [EuSEF-Regulation, (EU) No. 346/2013] make up the EU legal framework on venture capital. The EU-wide marketing of these funds is currently only open to fund operators managing less than EUR 500 million ("EU passport"). The Commission wants to look at increasing this threshold and to amend both Regulations in the 3rd Quarter of 2016. A consultation on this subject is under way. (p. 8 and 9)

  Lending by investment funds
  - European venture capital funds [EuVECA Regulation, (EU) No. 345/2013] and European long-term investment funds [ELTIF Regulation, (EU) 2015/760, see cep**PolicyBrief**] are permitted, to a limited degree, to issue direct loans to businesses (p. 10).
  - Alternative Investment Funds [AIFs, Directive (2011/61/EU), see cepPolicyBrief], such as hedge funds, commodity and real estate funds, can only lend to companies where this is permitted under the law of the Member State (p. 10).
  - By the end of 2016, the Commission wants to assess the need for a "coordinated approach" to lending by AIFs, and where appropriate, for regulation at EU level. (p. 10 and 11)

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Overcoming informational asymmetries between investors and SMEs

– The Commission sees informational asymmetries between small and medium sized enterprises (SMEs) and investors: SMEs are not sufficiently well informed about non-bank financing options and investors are lacking information about SMEs.
– In order to remove the asymmetries, the Commission wants (p. 9 and 10)
  - in the 2nd Quarter of 2016, to work with European banking federations and business organisations to develop a "structure" whereby banks declining credit applications must provide SMEs with information about alternative funding options.
  - in 2017, to develop a pan-European information system containing the funding and credit information of SMEs, in order to make it easier to bring SMEs and investors together; in this regard, the Commission wants to "build on" the business-loan database of the European Central Bank (ECB) ("AnaCredit") and on local and national structures; the participation of SMEs in these systems will be voluntary.

► **Building Block 2: Easier access to public capital markets**

– Companies wanting to obtain funds via the capital markets often have to provide investors with information by way of prospectuses [Prospectus Directive (2003/71/EC), see cep**PolicyBrief**].
– According to the Commission, prospectuses are often "costly and onerous to produce", particularly for SMEs, and for investors they are "complex and excessively detailed". It therefore wants to change the Directive [Proposal COM(2015) 583, cep**PolicyBrief** to follow]. In particular, it wants to (p. 12 et seq.)
  - streamline the approval process and the information requirements as well as
  - change the rules on when a prospectus is needed.
– Some market players are concerned about limited liquidity in the secondary corporate bond markets. This increases capital costs for businesses and thus makes borrowing less attractive. In 2017, the Commission therefore wants to review the "functioning" of the markets. (p. 13)

► **Building Block 3: Promoting long-term infrastructure investment**

– The Commission criticises the absence of a "distinct and suitably calibrated" method for calculating the regulatory capital to be held, by insurance companies and banks, for infrastructure investment.
– The Commission has given insurance companies their own asset class for infrastructure investment and relaxed the capital adequacy obligations [delegated Regulation [(2015) 6588/2]. It wants to assess whether the Capital Requirements Regulation for banks [(EU) No. 575/2013, see cep**PolicyBrief**] should also be amended accordingly. (p. 15 and 16)

► **Building Block 4: Fostering retail investment**

Increasing choice for retail investors

– The Commission criticises the fact that, despite "significant" levels of savings in bank accounts, participation by retail investors in the capital markets is limited.
– In its Green Paper on retail financial services [COM(2015) 630, cep**PolicyBrief** to follow] it therefore asks how to increase choice and competition with regard to financial products for retail investors. The impact of digitisation will also be looked at. (p. 18)

Promoting private pensions

– According to the Commission, due to the significant diversity of European and national rules, there is no genuine single market for private pensions. This makes it difficult to realise economies of scale and to diversify risks.
– By the end of 2016, the Commission therefore wants an EU rule for "simple, efficient and competitive" private pension products. (p. 19)

► **Building Block 5: Increasing the funding from institutional investors**

– In some Member States, SMEs can join up to form credit unions and are thus able to finance each other on a not-for-profit basis. In many Member States, such as the UK and Ireland, these credit unions are not subject to the EU capital requirements framework for banks. The Commission wants to examine whether all Member States "have the possibility" to authorise such credit unions to operate outside the capital requirements framework. (p. 21)
– According to the Commission, securitisations can increase the availability of bank credit and reduce the cost of funding. EU securitisation markets remain "significantly impaired" as a result of the financial crisis. In parallel to the Communication, the Commission has therefore proposed (p. 22)
  - a Regulation to establish criteria for "simple, transparent and standardised" securitisations [COM(2015) 472, cep**PolicyBrief** to follow] and
  - a Regulation changing the capital requirements for banks in relation to securitisations [COM(2015) 473].
– According to the Commission, the market for covered bonds – including mortgage bonds – is fragmented due to divergent national rules. This limits market liquidity, obstructs market access for investors and increases the cost of funding for banks. In parallel to the Communication, the Commission has therefore launched a consultation on a pan-European framework for covered bonds. (p. 22)

- **Building Block 6: Facilitating cross-border investing**
  - According to the Commission, cross-border securities transactions are obstructed by the fact that it is unclear which national law is applicable to them. This gives rise to uncertainty about rights of ownership and makes the assignment of debt claims, which is important for securitisations, more difficult. In 2017, the Commission wants to clarify which respective national law applies. (p. 23)
  - According to the Commission, the Regulation on over-the-counter derivatives trading [EMIR, (EU) 648/2012], see cep**PolicyBrief**], the Markets Directive [MiFID II, (2014/65/EU), see cep**PolicyBrief**] and the Regulation on Central Securities Depositories [CSDR, (EU) 909/2014, see cep**PolicyBrief**] has made cross-border investment transactions easier by improving clearing and settlement ("post-trading"). In 2017, the Commission wants to undertake a "broader" review of whether and to what extent EMIR, MiFID II and CSDR have removed barriers to cross-border post-trading (p. 24).
  - According to the Commission, inefficient and divergent national insolvency laws often prevent a reasonable assessment of credit risk in the case of cross-border investments. In 2014, the Commission, in a Recommendation, called upon the Member States to implement "early restructuring procedures". The Recommendation has been "only partially" implemented however. The Commission therefore wants to propose a "legislative initiative" on business insolvency in the 4th Quarter of 2016. (p. 25)
  - The Commission will strengthen the role of the European Securities and Markets Authority (ESMA) with the aim of achieving supervisory convergence in the EU.
  - In the 2nd Quarter of 2016, the Commission will submit a White Paper on the governance and financing of the European Supervisory Authorities [see also in this regard cep**Input** 04|2014]. (p. 27)

Policy Context

Commission President Juncker has declared the creation of a Capital Markets Union to be one of the priorities of his period of office. In February 2015, the Commission submitted a Green Paper containing its initial ideas on Capital Markets Union [COM(2015) 63, see cep**PolicyBrief**]. This Communication sets out these ideas in more detail.

Options for Influencing the Political Process

Leading Directorate General:	DG Financial Stability, Financial Services and Capital Markets Union
Leading Committees of the EP:	Economic and Monetary Affairs
Leading Federal Ministry:	Federal Ministry of Finance
Leading Committee of the BT:	Finance Committee

ASSESSMENT

Economic Impact Assessment

In principle, capital should be able to be channelled to the places where it can be used most effectively. **Removing obstacles to the free movement of capital across borders increases efficiency, strengthens competition and boosts the potential for growth.** The creation of a Capital Markets Union is therefore appropriate.

Crowdfunding via the internet promotes both competition on the funding market and innovations in all areas of the economy. Low transaction costs and the use of new means of communication allow start-ups in particular to get onto the "funding ladder". Uncertainty about the applicable rules is currently hindering crowdfunding. There must be harmonised EU legislation. Above a specified minimum investment sum or level of complexity, crowdfunding platforms should keep minutes of meetings, hand out prospectuses and provide objective and comprehensible information about the investment, on their website, and be liable in this regard for obvious errors.

EU rules on whether and **under what circumstances investment funds** – particularly AIFs – **are permitted to grant loans, are imperative.** As investment funds can be marketed across borders via the EU passport, national rules on lending have become obsolete. **Precise European criteria to distinguish lending funds from the more strictly regulated banks must prevent the latter from** evading the stricter rules by **operating their lending business via investment funds.** In addition, this would strengthen the problematic area of shadow banking [Green Paper COM (2012) 102, see cep**PolicyBrief**]. One possibility would be to allow only closed-ended AIFs to provide lending and to limit simultaneous borrowing and lending by funds. This could prevent the risk of contagion and reduce the similarities with banking operations.

European information systems about SMEs may remove informational asymmetries between SMEs and lenders and promote non-bank investment in SMEs. Participation in the European information systems should, as the Commission suggests, be voluntary so that SMEs are not obliged to publish confidential information about their business. The added value of such systems lies, however, in the fact that they provide a standard method of reporting and processing the information The ECB's AnaCredit initiative, whereby banks, for monetary policy and regulatory reasons, will be obliged to provide the ECB with detailed credit information, may provide a model for standardised information about SMEs. Using the data in the AnaCredit database for the SME information system should, however, be ruled out for reasons of data-protection.

The planned relaxation of prospectus obligations for SMEs is double-edged. Although a relaxation of the requirements would reduce the cost of gaining access to the public capital markets, it may also increase the

informational asymmetries between lenders and borrowers. This may jeopardise market efficiency and ultimately the actual financing of SMEs via the capital markets.

Promoting infrastructure investment by lowering the capital requirements for insurance companies and banks is risky. Firstly, there is hardly any data which provide a justification for lowering the requirements. Secondly, a level of capital which is not commensurate to the risk gives rise to misallocation with capital increasingly being channelled into infrastructure investment even though it would be more effectively used elsewhere. Thirdly, infrastructure investment often lacks the necessary diversification of risk. Fourthly, with regard to banks, the question arises whether infrastructure investment – in which funds are tied up for the very long term – could jeopardise liquidity.

An EU framework for pension products could strengthen cross-border competition and allow for economies of scale as a result of the pan-European distribution of the product. However, this sort of EU framework would also involve a – politically almost inconceivable – harmonisation in matters of social policy and tax law in order to remove the obstacles in the internal market.

Today, securitisations carry the stigma that they played a large part in bringing about the 2007 financial crisis. Basically, however, they provide an economically useful instrument for improving the diversification of risk on the financial markets and increasing the banks' lending capacity. **A label for "simple, transparent and standardised" securitisations may** – if adequately calibrated – counteract the stigma and **increase confidence in the securitisation markets.** For standardised securitisations to receive preferential regulatory treatment over other securitisations - such as by way of lower capital requirements - it is imperative that they have a systematically lower risk. Otherwise, not only will product diversity and innovation be restricted but the stability of the financial markets will be put at risk.

Harmonising the requirements for covered bonds facilitates cross-border investment particularly as a result of the lower information costs. This reduces the cost of funding. Full harmonisation is politically unrealistic in the medium term, however, because it would have to include EU-wide uniform rules on insolvency and real estate law.

The Commission should change the decision-making structures of the European financial supervisory authorities (ESAs). Decisions in the ESAs are currently made exclusively by representatives of the national supervisory authorities. Although they should always act "in the European interest" this structure nevertheless gives rise to a conflict of interest. It would be better to create an additional body which – similar to the ECB's Executive Board – does not contain national representatives. The European financial supervisory authorities should also be financed by both public and private funds from the respective sector. The argument for public funding is supported firstly by the public interest in adequate supervision and secondly by the fact that public funding allows for a certain amount of democratic surveillance by the European Parliament. However, the experiences of the financial crisis have taught us that the financial sector must also make a contribution since it has much to gain from a stable financial system.

Legal Assessment

Legislative Competency

The legal basis for harmonising financial markets regulation is provided by the internal market competence (Art. 114 TFEU) and by the competence to coordinate national provisions concerning the taking-up and pursuit of self-employed activities (Art. 53 (1) TFEU). The internal market competence (Art. 114 TFEU) is also available with regard to material harmonisation of national insolvency law.

Subsidiarity

Dependent on the actual design of the follow-up measures. Unlikely to be problematic, however, due to the cross-border nature of the financial markets.

Proportionality with respect to Member States

Dependent on the actual design of the follow-up measure.

Compatibility with EU Law in other respects

Dependent on the actual design of the follow-up measure.

Impact on German Law

In Germany, a change to the Investment Code will introduce rules on lending by certain AIFs. Further changes will be necessary if divergent EU rules are passed.

Conclusion

Removing obstacles to the free movement of capital across borders increases efficiency, strengthens competition and boosts the potential for growth. EU rules on whether and under what circumstances investment funds – particularly AIFs – are permitted to grant loans, are imperative. They make regulatory arbitrage between investment funds and banks more difficult. Promoting infrastructure investment by lowering the capital requirements for insurance companies and banks is risky. A label for "simple, transparent and standardised" securitisations may increase confidence in the securitisation markets.

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