



# European Commission Capital Markets Union Action Plan

## Roadmap to Freedom of Capital or Another Dead-End?

On 30 September 2015, the European Commission published its capital markets union ("CMU") action plan, setting out a high level overview of its proposals to strengthen the free movement of capital across the EU and to improve the efficiency of European capital markets. In this briefing note, we consider the possible implications of certain key measures for financial services firms and provide a summary of the relevant proposals.

The European Union is still implementing its programme of post-financial crisis financial services legislation. However most of that legislation has been agreed upon. The CMU action plan focuses on the next phase of EU financial services measures. Its stated aim is to support the Commission's goal of building a true single market for capital for the European Union.

The CMU action plan itself is available [here](#) and contains an indicative timeline for the implementation of the measures below in Annex 1 to the document. Much of the initial work is due to be carried out in 2016 and 2017. It is currently difficult to assess which of the proposals will result in significant new laws and which will be dealt with by way of more minor technical changes.

As a result, firms should pay careful attention to any new proposals throughout the next two years that may affect their businesses and should ensure that they respond to consultations (either individually or through industry associations) where appropriate to maximise opportunities to shape the future development of legislation in a positive way.

## KEY POINTS

### Key measures that the Commission has put forward in the CMU include

- a [general review of all post-financial crisis financial services legislation](#) to check for coherence and to assess its cumulative impact;
- a [consultation on changes to the existing EuSEF and EuVECA Regulations](#) (relating to European social enterprise and venture capital funds) which may introduce greater flexibility, coupled with a potential new EU framework for venture capital funds-of-funds;
- an assessment of whether there should [be a new regulatory framework for loan origination funds](#);
- a comprehensive [review of the EU market for retail investment products](#);
- an assessment of the [main barriers to cross-border distribution of investment funds](#);
- a [new securitisation framework for simple, transparent and standardised securitisations](#) and revisions to the existing EU Capital Requirements Regulation in connection with the regulatory capital treatment of investments in all securitisations;
- an [examination of the current EU debt-equity bias](#) and how it would be best to address this;
- an amendment to the [regulatory capital treatment of infrastructure and other long-term investments](#) by EU banks and insurers; and
- a review [of overall progress on the CMU in 2017](#).

We address each of these below. The relevant sections of this note may be accessed directly by clicking on the hyperlinks above.

## Proposals

### Review of existing financial services regulatory framework

The Commission states in the CMU action plan that EU financial services legislation must strike an appropriate balance between effective regulation and not creating unintended barriers to market activity. In order to assess whether the correct balance has been struck, the Commission has published an immediate call for evidence as part of a comprehensive review of the cumulative impact and coherence of all EU financial legislation that has been adopted in response to the 2007/08 financial crisis.

The call for evidence is available [here](#) and participants have until **6 January 2016** to submit their responses.

### Innovative financing proposals

A key component of the CMU action plan involves proposals that are designed to increase the availability of financing to small and medium-sized enterprises ("**SMEs**") within the EU and to encourage more innovative forms of funding. These include:

- A proposed assessment of the operation of loan-based crowdfunding across the EU, which may be followed by concrete measures to increase access to crowdfunding finance;
- Potential amendment of the EuSEF and EuVECA Regulations (relating to European social enterprise and venture capital funds) to allow larger AIFMs (i.e. those exceeding the €500 million threshold in Article 3(2)(b) AIFMD) to operate and market EuSEF and EuVECA funds on a passported basis. Other amendments may include reducing the current minimum investment threshold of €100,000, potentially allowing non-EEA managers to use the EuSEF and EuVECA designations and potentially broadening the

range of eligible asset classes in which such funds may invest. The Commission has published the relevant consultation document on these issues in conjunction with the CMU action plan – it is available [here](#) and firms have until **6 January 2016** to submit a response;

- Proposals to encourage the development of pan-European venture capital funds-of-funds;
- Supporting the development of pan-European information systems that are designed to bring together SMEs seeking additional finance and EU finance providers;
- A proposed assessment of whether there is demand for a regulatory framework for loan origination funds. Although EuVECA funds and European Long Term Investment Funds ("ELTIFs") can originate loans to a limited extent, the Commission considers that it may be desirable to clarify the regulatory framework for other investment funds that engage in loan origination. Although the Commission has indicated that this may lead to greater cross-border opportunities (potentially through the availability of passported loan origination activities, for example), it has noted that such funds would need to be "regulated appropriately from an investor protection and financial stability perspective". This may imply that the price of a cross-border passport may be additional compliance requirements, such as increased disclosure and reporting obligations and stronger prudential regulation; and
- Promotion of best practices on tax incentives to support innovative companies and start-ups. The Commission has noted that Member States will need to check the Commission's state aid guidelines to ensure that schemes promoting venture capital do not contravene state aid rules (as occurred, for example, in relation to the UK Venture Capital Trust Scheme and Enterprise Investment Scheme prior to amendments introduced in the 2015 Budget).

## **Encouraging retail and institutional investment**

The Commission is aiming to encourage retail investors to become more involved in the EU capital markets in order to encourage them to take action to meet their retirement needs. In addition, the Commission has also expressed concern that institutional investors are becoming increasingly focused on a narrow range of asset classes and is seeking to remove impediments to wider, more diversified investments. Proposals in this area include:

- A comprehensive review of the existing EU market for retail investment products, including both distribution of investment products and the provision of retail investment advice, focusing in particular on new possibilities to provide online financial services;
- Considering whether it is desirable to develop a new policy framework to encourage simple, efficient and competitive personal pensions;
- Gathering evidence on the main barriers to the cross-border distribution of investment funds, including any disproportionate marketing requirements, fees, tax arrangements and other arrangements. This may be followed by legislative action to remove unnecessary barriers at the Member State level, which could potentially ease the current regulatory burden associated with differing notification rules and compliance requirements under regimes such as the AIFM Directive; and
- Considering whether other changes to the regulatory capital treatment of investments by insurers (other than those relating to long term investments referenced above) are desirable, which may include amending the treatment of private equity and certain other investments to make such investments more attractive.

## **Encouraging banks to support the wider EU economy**

Although the Commission is seeking to encourage diversification away from bank finance, it also notes in the CMU action plan that bank finance will continue to be important to many businesses. In order to ensure that banks can continue to support the wider economy, the CMU proposals include:

- A new proposal to introduce an EU framework for simple, transparent and standardised ("STS") securitisations and to amend the regulatory capital treatment of investment in securitisations contained in the CRR. The purpose of the new STS provisions is to provide greater investor confidence and to reduce the burden of due diligence in respect of securitisations that are less complex and more transparent in their structuring. The regulatory capital proposals aim to introduce a more risk-sensitive approach to the prudential treatment of investment in securitisations with a clearer hierarchy of rules that should be applied. These legislative proposals were published alongside the CMU action plan and are available [here](#); and
- The development of a pan-European framework for the regulatory treatment of covered bonds. The Commission has published the consultation paper relating to this proposal - it is available [here](#) and firms have until **6 January 2016** to respond.

#### **Increasing access to public equity and debt markets and review of current bias in favour of debt**

The Commission has indicated that it is concerned about the cost of accessing the public equity and debt markets and is seeking to streamline the process. It has therefore made the following proposals:

- Modernisation of the Prospectus Directive to reduce the required information and to streamline the approval process for prospectuses of SME issuers;
- Working with any new SME growth markets established under MiFID II to ensure that they meet their purpose;
- A review of the functioning of EU corporate bond markets to consider how liquidity may be improved and to encourage voluntary standardisation of offer documents; and
- An examination of how to address the current debt-equity bias (for example, as a result of the current favourable tax treatment of debt due to the deductibility of interest payments). The overall aim is to create a stronger equity base in companies to encourage greater resilience to financial shocks, particularly in relation to EU banks.

#### **Proposals relating to the regulatory capital treatment of infrastructure and other long-term investments**

The CMU action plan contains a range of proposals designed to encourage long term investment, particularly in the infrastructure space, by amending the current regulatory capital treatment applied to such investments. These include:

- Amendment of the Solvency II Delegated Regulation to alter the regulatory capital treatment of investments by insurers in infrastructure investments and European long-term investment funds ("ELTIFs"). In addition, there will also be a separate amendment to the treatment of equities traded on multilateral trading facilities. The proposed amending legislation has already been published and is available [here](#); and
- Continuing the review of the EU Capital Requirements Regulation ("CRR") and adoption of future amendments to the regulatory capital treatment of infrastructure investments by banks if this is considered appropriate.

#### **Cross-border investment**

The Commission has recognised that there are still considerable barriers to cross-border investment across the EU. In order to lessen these barriers, it has put forward the following proposals:

- Building on work already done on securities ownership and proposing new pan-European rules for the assignment of debt claims to increase investor certainty;
- Reviewing progress on the elimination of the Giovannini barriers to cross-border clearing and settlement;

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- Identifying national barriers to the free movement of capital at the Member State level that result from insufficient implementation of EU law or divergence in interpretations of the single market rulebook for financial services;
- A legislative proposal to cause greater harmonisation of business insolvency and restructuring laws;
- Developing a code of conduct for withholding tax relief at the Member State level; and
- Continuing to assess the risks posed by market-based financing (formerly known as "shadow banking"), particularly in relation to market liquidity and interconnectedness between participants in the financial markets.

## Review

Finally, the Commission has indicated that it will carry out a comprehensive review of its progress under the CMU action plan in 2017 and will consider at that time whether any further action is required.

## FOR FURTHER INFORMATION, PLEASE CONTACT

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