

# What's next for the EU's Capital Markets Union project? Charting the path beyond 2020

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# Quick Take:

The EU's Capital Markets Union (**CMU**) project, which first launched in September 2015 has been relaunched in 2020. CMU "2.0" is the latest ongoing EU effort comprised of many "actions" and workstreams, which all aim to deliver on the overarching goals of:

- reducing barriers and integrating capital markets across the EU and facilitating greater cross-border investment as well as participation of retail clients;
- creating a more Single Market for financial services as well broadening sources and avenues of financing for European businesses; and
- ensuring a more sustainable and appropriate regulatory environment.

The European Commission (**EC**) has said that CMU should act as a catalyst to remove fragmentation across markets, legislative/regulatory regimes and the institutional architecture underpinning a collection of national markets, some of which remain too small to compete and attract global investors. CMU also provides a fundamental opportunity to move away from an over-concentration on credit institution led funding (i.e. lending) channels to market-based financing. The EC has been clear that CMU should transform and unite European markets to emulate or resemble the depth and liquidity that exists in the US, thus providing for a more diversified and a more shock-absorbent range of capital market originated funding sources. Consequently, investors (but equally issuers) should benefit from deeper, more liquid and integrated financial markets.

The European Commission's High-Level Forum on CMU in June 2020 took definitive steps to set out what CMU 2.0 should tackle and issued a roadmap (published on July 7 and closing for consultation on August 4, 2020) for EU policymakers to consider and implement. Following preliminary agreement by EU

policymakers on July 21, 2020, on the EU's Recovery Fund and the multi-annual financial framework (**MFF**) to set its budget to drive the economic recovery – details of which are set out in standalone coverage from our Eurozone Hub – the EU Commission is planning to finalize a flurry of further amendments to key parts of the CMU 1.0 initiatives, push CMU 2.0 and also amend other financial regulatory rules and supervisory expectations to drive the EU's economic recovery, as published on July 24, 2020 in an EU Capital Markets Recovery Package, as discussed in this Background Briefing. These include:

1. Simplifications to the MiFIR/MiFID II's information requirements, product governance and position limits;
2. Introducing an "EU Recovery Prospectus" regime and other reliefs for certain issuers;
3. Creating a framework for simple, transparent and standardized (STS) balance sheet synthetic securitizations, as well as amendments to the EU Securitization Regulation and the corresponding CRR Amendment Regulation framework more generally to help the post COVID-19 recovery; and
4. Introducing new powers under the EU Benchmarks Regulation (BMR) to set a statutory replacement rate.

CMU is not only a vital component in delivering a "more single" Single Market for financial services but also complements a range of other EU reform efforts to the EU's Single Rulebook for financial services more generally and thus presents opportunities across a range of market sectors and asset classes for both financial services market participants and non-financial corporates alike.

## Setting the path for action and taking targeted amendments

On June 10, 2020, the European Commission's (EC) High-Level Forum (HLF) on the future of the Capital Markets Union (CMU)<sup>1</sup> published its final report<sup>2</sup> (the **HLF Report**) promising a "new vision for Europe's Capital Markets" followed by a short consultation period that closed on June 30. The EC published a roadmap on CMU 2.0 (officially: "A CMU that supports people and businesses") on July 7 (the **HLF Roadmap**)<sup>3</sup> with comments requested until August 4, 2020, i.e., a very short period indeed even if the Roadmap runs to two pages compared to the ca. 150 pages in the HLF's Report.

The announcements in the HLF Report and HLF Roadmap should also be read in conjunction with the announcements that the European Commission published for consultation on July 24, 2020, (the **EU Capital Markets Recovery Package**) in tweaking CMU 1.0, 2.0 and other non-CMU rules such as the MiFID II/MiFIR regime, the Benchmarks Regulation and the Prospectus Regulation.

This Background Briefing assesses the outcomes and priorities for policymakers following the HLF's final findings and the feedback from the consultation period set out in the HLF Report, the range of additional rule changing announcements in the EU

Capital Markets Recovery Package, as well as what regulatory obstacles and/or opportunities this might mean for both regulated market participants and for non-financial corporates.

## Why 2020 is different for CMU 2.0

Completing the Single Market has been one of the core components of the EU's founding treaties, and various targeted harmonizing workstreams<sup>4</sup> in financial services go back well into the 1980s. CMU 1.0's launch in 2015<sup>5</sup> reflected the efforts to revitalize some of the reform efforts that stalled ahead of the 2008 financial crisis and 2010-2012 sovereign debt crisis, as well as to plug the gaps identified by those events and concurrently drive forward capital markets integration to complement the harmonization drive introduced by the start of the Banking Union.

Shortly after its launch, the Brexit referendum and ensuing refocusing, along with the onset of the COVID-19 crisis<sup>6</sup> in 2020, have provided a catalyst for getting CMU 2.0 agreed, advanced and implemented. EU financial markets if left to continue fragmented along national lines laws and institutions are a barrier to greater cohesion. This is especially true for the EU's Single Market (not just for financial services) that is reliant on the functioning of a more single, uniform and consistent application of the Single Rulebook. In contrast to past

1. For a background on CMU, please also see Michael D. Huertas in: "The EU's Capital Markets Union in 2016: Where are we now?". *Journal of International Banking Law & Regulation*, Vol 31, Issue Nr. 5 (2016); "Capital Markets Union and the Need for Greater Retail Investor Participation in Financial Markets: Is Now the Time for an EU-wide ISA?". *Journal of International Banking Law & Regulation*, Vol. 31, Issue Nr. 9 (2016); and "A Little Less Conversation, a Little More Action? EU Unveils the CMU Action Plan for Retail Financial Services". *Journal of International Banking Law & Regulation*, Vol. 32, Issue Nr. 8 (2017).

2. Available [here](#).

3. Further details available [here](#).

4. With differing degrees of scope and depth as well as results, often being delivered in a vertical fashion as opposed to a horizontal approach across types of asset classes, transaction types and market participants. Such a piecemeal approach may yield and accelerate an often disjointed approach with other reform workstreams. CMU 1.0 and now 2.0 is supposed to change this.

5. CMU "1.0" was conceived and commenced originally as an ambitious project for the EU-28 in mind, with a somewhat more muted "Action Plan" and was supposed to be completed by 2019. Following a "comprehensive stock-take" in 2017, which concluded that "more needed doing", the EC also published its Consumer Financial Services Action Plan on March 23, 2017. With a range of political developments (including Brexit) impacting this timeline, CMU is now set for a new reinvigorated delivery as "CMU 2.0", thereby ensuring ensure this flagship project delivers on its aims and does not, as was the case in CMU 1.0., become captured by multiple consultation rounds on known issues as opposed to advancing legislative and non-legislative action.

6. COVID-19 and the economic impact means that all EU economies are facing much higher levels of public and private debt and many businesses affected by a prolonged lockdown and/or distorted operating conditions will require substantial new forms of capital markets driven funding.



integration efforts, CMU 2.0 is set to be delivered in respect of markets and participants that are far more digitized than ever before. Consequently, CMU 2.0, as proposed by the HLF Report and Roadmap, appears to be a much needed progression from CMU 1.0, one that can deliver critical change to an EU that is facing a watershed moment.

Before delving into the details of CMU 2.0, the HLF Report, the HLF Roadmap and the EU's Capital Markets Recovery Package, it is important to understand what previous Single Market integration efforts<sup>7</sup> preceding CMU 1.0 as well as the CMU 2017 stock-take did or, as has been more the case, did not do, and what that means for CMU 2.0.

### Putting CMU 1.0 and previous integration efforts into the context of CMU 2.0

The original CMU 1.0 Action Plan scheduled a number of items to be advanced in 2016 and 2017, yet it lacked, irrespective of the breadth of its ambition and the phased delivery, some of the "action" that the preceding CMU Green Paper had indicated would be delivered and which many public commentators had hoped for. The CMU 1.0 Action Plan<sup>8</sup> stated "there is no single measure that will deliver a Capital Markets Union". This statement then, as is the case now in 2020, begs perhaps to be challenged.

Even if there is no "CMU Model Act"<sup>9</sup>, the EC could revisit earlier planned harmonizing legislation, such as the 2010/2011 proposed Draft Securities Law Legislative package, so as to allow it to become an EU version of the US's Uniform Commercial Code, which contributed markedly, and could achieve the same in the EU-27, to advancing a more integrated capital markets and particularly a collateral ecosystem. As in 2015, CMU 2.0 is still lacking in the scope of its coverage, tangible legislative and institutional

harmonization and convergence efforts on post-trade activity and infrastructure (notably collateral and custody).

The same is also true of CMU 1.0 and 2.0 in the lack of discussion of stalled efforts to improve the EU's scope of coverage, disclosure, protection levels and faster payout speeds in the Investor Compensation Schemes Directive (**ICSD**) to match the increase in protection levels undertaken in respect of the EU's Deposit Guarantee Scheme Directive (**DGSD**), which was markedly improved ahead of the 2014 start of the Banking Union. The DGSD, which is subject to ongoing improvement efforts in light of the proposed Pillar III to the Banking Union, the European Deposit Insurance Scheme (**EDIS**) project, has helped encourage cross-border deposits but work on EDIS remains yet to be finalized. In contrast, the previous proposals to raise the ICSD level of €20,000 (the current level of protection) to an uniform €50,000 in the 2010 legislative proposal and in the 2011 proposal to a tiered level ranging between €30,000 and €100,000 (i.e., the same level of protection afforded in the DGSD). But could (and should) more be done?

By way of comparison, the United States' Securities Investor Protection Corporation (**SIPC**) protects (retail and certain SME eligible) investors against the loss of cash and securities held by a customer with a financially troubled SIPC member firm. Protection levels are up to a value of US\$500,000 of which US\$250,000 is the applicable limit of cash held.<sup>10</sup> Protection for multiple accounts is available depending on the type of capacity the customer acts in. These protection levels are considerably higher than in the EU's DGSD let alone the ICSD framework and inaction is perhaps a missed opportunity even though (see point 16 of the HLF Report's recommended actions summarized below) the HLF

7. These previous integration efforts included the Financial Services Action Plan (**FSAP**) as well as the EC's White Paper on Financial Services Policy (**FSWP**). While the FSAP and FSWP had different objectives (less ambitious goals), they were not as cautious as the CMU Plan. They thus presented and delivered more action in the form of legislative instruments and tangible changes that improved market harmonization and standards. Both the FSAP's and FSWP's action points that were delivered still form the foundation of the EU's current financial services regulatory regime, even as amended through the post-2008 crisis regulatory reforms, to which CMU is to be applied.

8. The original CMU 1.0 Action Plan received 700 responses, which led the European Parliament and Council to argue the need "for taking a step-by-step by approach, and that the issues identified in our consultation [the CMU GP] were the right ones on which to concentrate".

9. And no uniform code or voluntary/complementary regime, to deliver all of what CMU is tasked to do. CMU 2.0, unlike earlier efforts, aims to make greater use of "legislative bridges" in the form of targeted instruments to harmonize interoperability of CMU and non-CMU reforms. Market participants will still need to, working together with counsel, conduct impact mapping exercises to navigate these new rules.

10. It should also be noted that the US equivalent of the DGSD, the Federal Deposit Insurance Corporation (**FDIC**) protects consumers in a harmonized fashion up to the value of US\$250,000 per depositor, per insured FDIC firm per each account in each type of covered category. Both SIPC and FDIC provide considerably more protection than anything the EU has ever delivered and the EC should now in 2020, as it perhaps should have done in 2015, considered this as a CMU deliverable, in particular in terms of tangible benefits for consumers, and thus encourage retail investor participation.

hints at some possible improvements if the EC and EBA pursue what are described as “further initiatives”.

A similar situation also applies in relation to the EU’s insurance sector and the lack of an equivalent insurance guarantee protection through a standalone or unitary scheme, such as provided for example by the UK in its Financial Services Compensation Scheme (FSCS), which currently gives uncapped protection coverage for certain eligible claims.<sup>11</sup> The EU’s efforts with respect to insurance guarantee schemes remains in 2020, as in 2015, limited to a landing page.<sup>12</sup> In light of pressures posed by COVID-19 on markets, financial services firms (across all market and asset types) and their dealings with clients, notably consumers, CMU 2.0 could do more in these areas to increase protection and to do so by placing participants on an equal footing.

Furthermore, CMU 1.0 and 2.0 do not advance efforts, which stalled between 2010 to 2012, to create more harmonized rules or schemes to deal with consumer complaints or regulatory complaints. This has often been seen as a barrier in that retail investors may be deterred from venturing beyond their national borders or engaging with EU financial services firms passporting services into their jurisdiction if they have no clarity on to whom and how they may complain. Despite a number of responses on this point having been considered by the EC prior to the publication of the CMU 1.0 Action Plan, the only real efforts have been to update “FIN-NET”, the financial dispute resolution network that the EC set up in 2001. In comparison to most national ombudsman offices or consumer protection authorities, the operation or even the existence of FIN-NET remains fairly unknown to consumers and any upgrade would probably be welcome and easily achievable and thus reinforce retail investor confidence.

As lamented in 2015, CMU 2.0 also does not call for the creation of a new single CMU supervisor as a

true pan-EU/Eurozone supervisor (dubbed the SEC), so as to achieve what the European Central Bank (**ECB**), in its role at the head of the Single Supervisory Mechanism (**SSM**), has achieved in a transformative manner by advancing the Single Rulebook within the Banking Union. Nor does CMU 2.0 empower the European Securities and Markets Authority (**ESMA**) to assume such a role. This therefore raises the question whether a CMU can be achieved without institutional supervisory architecture changes as has been the case with the Banking Union. Having an integrated Single Market in financial services (outside the banking sector) without an integrated supervisory authority (beyond those mandates allocated to the ESAs – ESMA, EIOPA and EBA)<sup>13</sup> appears to be a fundamental contradiction to what CMU (2.0) is very much looking to achieve to begin with. Supervisory convergence amongst national competent authorities (**NCA**) in the EU-27, as coordinated by the respective ESAs, is a welcome but perhaps insufficient step, leading to a situation where the CMU aims to do more than the Banking Union but with less powerful tools. Why these items above were not addressed in CMU 1.0 and now in CMU 2.0 is strange, especially since the CMU’s objectives are to improve resilience and confidence in capital markets (including from retail investors) and open up non-bank lending and funding alternatives.

In light of the above, EC policymakers, but also market participants responding to consultations in respect of advancing CMU 2.0, have a unique opportunity, in part to combat COVID-19, to drive forward sensible changes that push capital markets integration, level the playing field and open it up for greater efficiencies for financial services firms in engaging with their counterparties and clients. The High Level Forum’s (**HLF**) Report, discussed below, goes a further step in setting out what the EC should aspire to, as well as key points of technical detail the EC ought to legislate on and more importantly how.

11. This specific point of a lack of sufficient coverage in relation to failing insurance firms and the uneven playing field and protection levels was recognized in the conclusions reached in the FSAP and FSWP. It has not been addressed in CMU 1.0 nor in 2.0.

12. Available [here](#).

13. Another proposition, that was first raised in 2015 and which remains valid in 2020, is how to increase how listing authorities operate and cooperate with one another. Whilst much of the EU listing regime is already harmonized through EU law, convergence could be increased on how those rules are administered. Even if that suggestion could still, as was the case in 2015, be viewed unfavorably by some Member States, notably those that have sought to differentiate the position of “their” domestic markets on the basis of “their” listing standards, action could drive integration and thus propel the path towards more liquidity of an execution venue with consistently robust standards. Equally more perhaps could be done, as was called for in 2015, to make cross-border and dual listings within the European Economic Area more of a reality. The same applies to the use/attractiveness of European or Global Depository Receipts or even emulating the London Stock Exchange’s efforts in an International Order Book. All of this might help debunk the myth that issuers should list in their home/domestic markets and that investors otherwise face too high levels of information asymmetry on “foreign” issuers.



### **CMU 2.0 – the watershed moment that EU financial services have been waiting for?**

In the HLF Report, the authors described how “Europe has for decades struggled to make its capital markets work as one, and to a large degree still has 27 capital markets, some fairly large, and quite a number rather small. With the UK having left, a question for politicians is how much of this market one wants onshore, and how much offshore.” The preface of the HLF Report goes further to state that “the report contains not abstract ideas or high level principles that should be achieved, but very precise and clear recommendations on what should be done in order to move Europe forward. We emphasize that this is not a menu from which one can order two or three

courses, and go home satisfied. The 17 clusters of measures are mutually reinforcing, and dependent on each other.”

While the changing political relationship between the EU-27 and the UK may prove to be an additional opportunity and catalyst for a reinvigorated CMU, the issues above that are still missing from CMU 2.0 remain an item that EC legislative policymakers but also the regulatory and supervisory policymakers should and could well address. This is particularly important as the HLF Report’s preface focuses on retail investors, stating that “European citizens as long-term savers and individual investors – who are one of the primary funders of the capital markets and of the economy – too often get poor net long term real returns. Providing cross-border access to simple,

comparable, cost-efficient and transparent products that provide sustainable value for money is key for savings, and key for investments.”

Irrespective of the criticisms, the HLF has clearly indicated that CMU 2.0 is now set to move from consultation to targeted action on existing known issues, as well as those new priorities, such as a more sustainable finance architecture, including a focus on tackling environmental, social and green investment standards to help the EU implement its Green Deal targets on climate neutrality. Equally, the HLF and CMU 2.0 are more joined-up with regulatory reforms and supervisory developments that are being advanced by policymakers concurrently. Greater interoperability of new rules and institutional change to the supervisory architecture across the EU-27 and efforts in other global financial markets are indeed welcome.

The HLF Report and Roadmap call for the following actions to be taken by the European Commission in the short, medium and over the longer term. The HLF Report points to the need for “timely, full and unwavering political backing at the highest level on a clear plan. This process is critical.” And it calls for the EC, the European Council and the European Parliament to “commit upfront and jointly to a bold and precise package of reforms, including a joint delivery timetable, monitored and enforced by all the institutions. Member States should also commit to swiftly and faithfully implementing the agreed measures and pursuing complementary measures at

national level in domains where there are no policies yet at EU level.”<sup>14</sup>

Before delving into the list of actions that the HLF has grouped into four clusters (A. the financing of a business; B. market infrastructure; C. individual investors’ engagement; and D. obstacles to cross-border investment), the HLF has identified the following obstacles and how CMU 2.0 could, in a self-reinforcing manner with spillover effects, overcome them. While not new, certainly compared to CMU 1.0 (especially after the 2017 stock-take), these have been reframed as follows:

1. Enhancing trust and confidence of EU citizens in EU capital markets;
2. Simplifying the existing rules and reducing legal uncertainty from different application and enforcement of rules across Member States;
3. Addressing unintended consequences of the existing legislation and high compliance costs;
4. Improving access to and reducing the costs of information;
5. Reviewing investment barriers; and
6. Incentivizing the use of new digital technologies.

The HLF also (reiterates the previous) calls for “smart regulation and efficient supervision that will widen and deepen EU capital markets whilst preserving financial stability, market integrity and investor protection”. Legislators should furthermore ensure that all new rules make the EU more competitive, without defining what competitive means and in respect of which comparables, and any proposal should aim to simplify the rules to build a “trust relationship” with market participants, including through pro-active communication on the status of CMU deliverables. The HLF further calls upon public authorities to encourage private initiatives. New rulemaking (or amendments) should also be preceded by a systematic evaluation as part of an impact assessment of whether rules reduce burdens for capital markets, market operators and end-users. In this context, the HLF points to the “one rule in, one rule out” approach propagated by EC President Von der Leyen.

Consequently, the HLF Report calls on the EC to progress the following actions under the following headings in order to advance CMU 2.0:

Actions under the heading “Creating a vibrant and competitive business environment”:

1. **Centralization of company data and its availability:** The EC should duly mandate ESMA and equip it with appropriate funds and resources to set-up the European Single Access Point (**ESAP**). ESAP would act as a single place for financial and sustainability-related information, which would also seek to interconnect existing national and EU registers and databases of company data, while expanding the type of data available gradually and progressively.<sup>15</sup> The HLF says the ESAP should overcome the fragmentation of where information is held, which discourages investors, especially from other Member States and third countries, from accessing information relating to smaller issuers (or operating in smaller capital markets), including small and medium-sized enterprises (**SMEs**). The EC is requested to make a proposal by mid-2021, with Stage 1 of the ESAP implementation by 2Q 2023, Stage 2 by 2025 and Stage 3 by 2028.
2. **Amending rules and tax treatment for European Long Term Investment Funds (ELTIFs):** The EC should implement targeted amendments to the ELTIFs’ current legal framework, coupled with national tax incentives (simplifying tax rules and/or providing preferential treatment), to accelerate the take-up by investors (including retail investors) with a long-term investment horizon. ELTIFs were originally conceived as a financial instrument to address lack of late-stage venture capital financing in the EU, notably compared to other economies, but the take-up has been slow. The reviewed framework should strengthen the ELTIF passport, encourage more participation from retail investors through more flexibility in redemptions or tax incentives, as well as broaden the scope of eligible assets and investments, while taking into due account investor protection. The HLF requests that the EC carry out the ELTIF review by end-2020.
3. **Proposing necessary, prudentially sound**

14. While this statement is welcome, it could be interpreted as not fully following the ideas of convergence being led at the EU level if individual Member States could take their own initiatives, which even if complementary, could drive fragmentation.

15. The EC could leverage the role of the European Data Warehouse, itself referenced in the EU’s Securitization Regulation, a CMU 1.0, flagship project in which the European Data Warehouse has continued to expand its central role in collating information from issuers for the benefit of investors.



**amendments to encourage significantly higher investment by the banking and insurance sector in capital markets, notably equities and SMEs (see the EU Capital Markets Recovery Package which already advances this deliverable):**

This could be done by carrying out a targeted review of Solvency II and by paying attention to provisions affecting market making and long-term investment in SME equity by banks and non-banks when further implementing Basel III standards into the CRR/CRD IV regime, as amended by CRR 2/CRD V and equally the Investment Firms Regulation and Investment Firms Directive. The HLF requests that the EC issues its proposal by mid-2021 and puts forward the IASB Resolution in 2021.

4. **Advancing a series of targeted, prudentially sound amendments to improve the EU securitization framework (see EU Capital Markets Recovery Package, which already advances this deliverable ahead of the HLF timeline of an EC proposal by end 2020):** The EC will work to simplify the process for significant risk transfer assessments, adjust the prudential treatment of securitizations for banks and insurers, support the development of a proportionate regime for synthetic securitizations, and reconsider their eligibility for liquidity purposes as well as simplify disclosures.
5. **Proposing amendments to simplify compliance for SMEs with the Prospectus Regulation as well as the Market Abuse Regulation, and foster greater transparency as well as changes to the MiFID II unbundling rule (see EU Capital Markets Recovery Package, which already advances this deliverable ahead of the HLF timeline of an EC proposal by mid-end 2021):** The EC aims to reduce compliance burdens so as to reduce what is perceived as compliance-driven reluctance to list on public markets. The EC's amendments will clarify what constitutes preliminary information and when inside information needs to be disclosed to the public. In terms of MIFID II and the unbundling rule, the amendments introduce an exemption from an obligation for brokers to charge separate fees for trade execution and research for SMEs, with the term of SME itself being broadened in this

regard to cover more companies. Consequently, this rolling back of the unbundling rule, as applicable to SMEs, should, as the EC hopes, contribute to greater research coverage of SMEs and thus investments. Equally, the changes aim to streamline the application of International Financial Reporting Standards (IFRS) for SMEs and to encourage the creation of SME indices.

6. **Calling upon the EC to review existing financial legislation to clarify the application to crypto/digital assets and, where appropriate, propose new EU legislation to regulate assets that fall outside the existing regulatory framework (see EU Capital Markets Recovery Package, which already advances this deliverable ahead of the HLF timeline of an EC proposal by end-2020 for existing legislation and end-2021 for other legislation):** While this is certainly not a new but a recurring call for the EC to take concerted action<sup>16</sup>, as certain Member States such as Germany have already jumped the gun<sup>17</sup>, the HLF Report does make it clear that the existing financial services regulatory perimeter needs to take a harmonized approach in assessing, with full legal certainty, whether a crypto/digital-asset should be categorized as a financial instrument and regulated as such and what to do with those that fall outside of this new expanded perimeter.  
  
Actions under the heading "Building stronger and more efficient market infrastructure" include:
  7. **Directing the EC to conduct a targeted review of the Central Securities Depository Regulation to strengthen the CSD passport and improve supervisory convergence amongst NCAs:** In addition, the ECB is invited to consider facilitating access to non-domestic central bank money within the EEA. The HLF calls for the EC to put forward its legislative proposals by mid-2021.
  8. **Recommending that the EC revises the rules on shareholders' rights:** by (i) putting a forward a Shareholder Regulation (instead of just the current Directive) to harmonize the definition of a shareholder; (ii) amending the shareholder rights legislation to clarify and harmonize the rules on the interaction between investors, intermediaries

16. See coverage from our Eurozone Hub on the EU's proposals along these lines available [here](#) and [here](#) where we had pointed to this development of the EU's own crypto-asset specific (CAS) regime.

17. See coverage from our Eurozone Hub on Germany's own crypto-asset regime available [here](#).



and issuers in respect to the exercise of voting rights and processing of corporate action; and (iii) in cooperation with NCAs facilitate the use of technology to enable wider investors' engagement and make the processing of corporate actions more efficient. The HLF calls for the EC to put forward its legislative proposals by end-2023.

9. **Requesting that the EC address standards on cloud outsourcing (note the ESMA has taken the first steps to build upon the EBA's work):** by (i) developing voluntary contractual standard clauses to enable financial institutions to better assess and manage risks related to their reliance on cloud services providers; (ii) developing a harmonized legislative framework to ensure the secure use of those services; and (iii) improving the digital competitiveness of the EU by encouraging the development of EU cloud providers. The HLF calls for the EC to develop contractual clauses by end-2020 and put forward proposals on cyber-resilience by end-2020.
10. **Encouraging the EC to, in building on the results of existing studies, assess whether the comprehensive coverage, improved quality of data and data standardization required to build a consolidated tape would contribute to capital flows in the EU:** The arguments for and against a consolidated tape have in part ebbed with the UK's departure from the EU, but the HLF's lukewarm indication on how to proceed in respect to the consolidated tape project will be deferred till the outcome and amendments from the ongoing legislative review of the MiFIR/MIFID II regime.

Actions under the heading "Fostering retail investments in capital markets"<sup>18</sup> include:

11. **Calling upon the EC to develop: (i) a dashboard to measure Member States progress on pension adequacy and sustainability; (ii) pension tracking systems; and (iii) taking a leaf out of the UK's efforts, the introduction of auto-enrollment systems to stimulate adequate pension coverage across all Member States:** The EC is encouraged to use political persuasion for Member States to use legislative and non-legislative means, or to advance EU efforts of a similar nature, including raising awareness amongst retail investors to achieve these aims to

improve long-term retirement and also accelerate the adoption of the pan-European personal pension product (**PEPP**) across the EU-27. The HLF calls for the EC to press ahead with greater introduction of pensions auto-enrollment by end-2021 and a dashboard and tracking systems by end-2021.

12. **Encouraging the EC to undertake a series of actions to support Member States in improving EU citizens' financial literacy:** Aside from the EC being requested to develop a common framework for financial competence for citizens (for how to plan a budget, invest, borrow) to be included in education programs, including under Erasmus+ efforts, Member States should be encouraged to support financial guidance being provided to consumers in relation to investing and pension planning and saving, including through digital means. Equally, in the HLF's view, the EC ought to promote the use of (the in some corners rather controversially viewed) Employee Share Ownership to encourage citizens' participation in capital markets and the development of what the HLF calls an "equity culture".
13. **Recommending that the EC make the following far reaching changes that the EC should deliver between 2020 and 2022:**
- Introduce measures to ensure professional advisers have an adequate level of qualifications, knowledge and skills so as to enhance trust by introducing a voluntary regime for a certificate and a pan-EU label for financial advisers – again this has hallmarks of the UK's Retail Distribution Review's experience in improving standards;
  - Study the role of inducements in the a context of advice and align the inducement rules across financial market legislation;
  - Create a new category of non-professional qualified investors;
  - Reassess disclosure rules with a view to making them more coherent, more understandable for retail investors and accessible in a digitally-friendly way;
  - Review the EU's PRIIPs Regulation;

18. Which interestingly makes no mention of the CMU 1.0 work (and on-going efforts stemming from that) in respect of retail financial services and improving retail client market participation.

- f. Promote the availability and use of independent digital comparison tools as well as more generally the benefits of simple and transparent investment products, which could be sold using automated advice and thus create economies of scale in the distribution of standardized transparent investment products.

**14. Inviting the EC to introduce a harmonized “open finance” regulatory framework covering financial and non-financial information relevant to facilitating financial planning or encouraging investment:**

The HLF describes an “open finance” approach as one that provides consumers with a comprehensive view of their financial situation. While a number of private sector solutions exist to present this data to consumers, the experiences of the then UK’s Financial Services Authority in requesting banks create a “single customer view” for resolution planning and DGSD payouts was a vital step from the regulator’s perspective and one that the relevant banks then monetized through add-on services to customers by having access to their financial and investments assets as well as via analysis of spending patterns (with that bank/group). The HLF pushes the EC to go further by “...building on experience from the existing framework for current account data-sharing between banks and payment service providers” i.e., through APIs as enabled by the EU’s PSD II regime. It proposes that this would “...enable consumers to obtain a comprehensive view of their financial situation, easier access to tools that compare costs of financial products, and be better positioned to switch providers where appropriate.” Given that the enthusiasm for this “open finance” approach may differ across certain EU market participants, the HLF further states “when determining the scope of data to be shared and the exact requirements, a level playing field between operators should be ensured”; sadly that statement does not explain what is meant by that vague goal.

Actions under the heading “Going beyond boundaries across the internal market” include the HLF restating that national anchored barriers in relation to taxation and insolvency regimes (but sadly not in relation to post-trade infrastructure) and diverging supervision and resulting arbitrage over the uneven consumer protection remain the main obstacles to capital market integration. Consequently, the HLF calls upon the EC to:

**15. Put forward a legislative proposal to introduce a standardized system for relief at source of withholding tax based on authorized information agents and withholding agents.**

This proposal calls for a single digital EU system based on EU law, common definitions, common processes and a single form of documents that would make it easier to rebalance taxes paid cross-border, while reducing administrative burden and costs. This in turn, it is proposed, would facilitate cross-border investments and reduce fraud, as a single EU system would allow investors to obtain an immediate relief at source on withholding taxes for investment income.

**16. Adopt a legislative proposal for minimum harmonization of certain targeted elements of core non-bank corporate insolvency law and, in cooperation with the EBA, undertake further initiatives.**

Specifically this would entail the EC setting out common rules across the EU to recover the value of investment in the case of companies’ failure, though this does not specifically address the issues and the missed opportunity raised above on the ICSD. The HLF also points to the fact that convergence towards more efficient and predictable insolvency procedures would also help banks tackle non-performing loans/exposures and thus help strengthen the CMU but also complete the Banking Union.

**17. Transition increasingly towards the use of EU Regulations as opposed to Directives to strengthen convergence on rulemaking and supervision without compromising the substance and form of Directives that work well.**

The HLF members concluded (perhaps incorrectly) that regulatory harmonization should be pursued first before a transfer of competences from NCAs, through an institutional change, to a centralized CMU supervisor be contemplated. This view runs contrary to those that advocate creating a central CMU supervisor regardless of divergent rules. Consequently, while the HLF does not formally put forward a recommendation on which of these views it would push for, the HLF concurrently clearly lays out the merits plus the actions needed to strengthen and expand ESMA’s (which would be the CMU central supervisor) and EIOPA’s (but not the EBA’s?) horizontal powers to enhance EU supervisory convergence. Institutional improvements would also include reforming their governance and strengthening their powers

and toolkits, including with wider powers in crisis management and adequate resources. Equally, and similar to the Banking Union and the ECB's role at the helm of the SSM, the members of the HLF believe that the largest and most systemic entities are likely to be the most appropriate for EU-level supervision by ESMA, notably large trading venues, large EU investment firms and asset managers with significant cross-border operations and large subsidiaries of third-country investment firms operating in the EU. ESMA should also have direct supervision powers in respect of the approval of prospectuses for wholesale non-equity securities and third-country issuers. EIOPA should also be granted direct supervisory powers over large insurers and re-insurers. Those in favor of extending direct EU-centralized supervisory powers argued that other entities should remain supervised by the NCAs.

### **HLF Report's identification of accompanying measures and principles (AMPs)**

In addition to the 17 action points above, the HLF Report calls for the EC to take legislative and non-legislative (including institutional) reform actions in respect of the following AMPs to deliver CMU 2.0:

18. **More in-depth work on a "safe asset" would be necessary.** Finalizing work in this field by policymakers would be complementary to completing and strengthening the Banking Union as well as advancing CMU while stabilizing the financial system as a whole. EU safe assets would create an important EU-wide benchmark for EU asset valuation and contribute to further asset diversification and risk sharing across the EU.
19. **Strengthening the anti-money laundering and financial crime (AML) prevention framework.** Notably, in addition to improving the legislative framework, the HLF acknowledged the importance of integrated supervision of compliance with AML rules across the EU.
20. **Improving pan-EU dispute settlement mechanism for bilateral investment treaties.** Building upon the conclusion by 23 out of 27 EU Member States, the need to implement the dispute settlement mechanism would be welcome to support cross-border investments.

21. **Foster regional cooperation of smaller market infrastructure operators to drive integration** – provided this is in compliance with EU rules on competition.
22. **Redress the bias for taxation benefits in respect of debt instruments** - and so alleviate pressures on equity investments. The HLF states that as long as debt continues to be subject to preferential tax treatment, all other conditions being equal, operators would continue to favor debt over equity. The HLF flags that, while the EC put forward a legislative proposal in 2016 to resolve this issue, it should relaunch work on the Common Consolidated Corporate Tax Base that has been stuck with the Council.
23. **Establish key performance indicators so that the EC can monitor the implementation of the CMU package proposed by the HLF.** The HLF, however, does not, in this AMP or the remainder of the HLF Report, suggest what these key performance indicators might be.

While the above is of course welcome, and hopefully achievable politically, the EC will need to tread carefully to advance these points with a steady momentum. The EU Capital Markets Recovery Package set the first steps towards that path, with possibly more to follow, notably as a wider-EU CMU 2.0 Action Plan is set to be published in September 2020.

### **Introducing the EU Capital Markets Recovery Package**

On July 24, 2020, the EC published the following set of legislative reform proposals for individual consultation. Some but not all of these address the HLF Report's action points – even while the HLF Roadmap remained subject to consultation. It is conceivable that the EC will use the remainder of 2020 to advance the other (and hopefully all) points, including those that have stalled since CMU 1.0, as well as previous integration efforts that would benefit markets and participants.

The EU Capital Markets Recovery Package unveils "quick fixes" with targeted amendments largely in line with the HLF Report's calls for action. The new amendments also aim to support those finalized by the EU in its April 2020 Banking Package<sup>19</sup>. When

19. Details of which are available [here](#) and which were discussed by our Eurozone Hub [here](#).



taken together these packages also aim to support the EU's overall COVID-19 response and recovery strategy and will be supplemented by the September 2020 scheduled CMU 2.0 Action Plan.

In the interim, the EU Capital Markets Recovery Package addresses, in a 54-page Commission Staff Working Document, setting overall policy details and justifications<sup>20</sup> for the changes to the status quo as complemented by subsequent, what the EC describes as "light-touch" (but certainly welcome), adjustments to the Prospectus Regulation framework. It also addresses the MiFIR/MiFID II regime, as well as more targeted adjustments to the EU Securitization Regulation framework. The proposals for consultation include:

- **Simplifying MiFIR/MiFID II's information requirements, product governance and position limits<sup>21</sup>** by introducing a number of amendments in areas that were identified during the MiFIR/MiFID II Review<sup>22</sup> as being overly burdensome or hindering the development of European markets. Lesser-experienced investors will remain subject to the same regime. These reliefs are, save for the temporary suspension of best execution reports for two years after the amendment enters into force (and subject to the full MiFID II review in 2021), permanent measures and include:
  - **Phasing out of paper-based communications with retail clients and replacing this default method with documents being provided in electronic format** (subject to a right of retail clients to opt in for paper-based information). Firms will need to consider whether this welcome saving of costs and burden would need to be aligned with any internal policies and procedures that apply to those types of retail clients that have been categorized as vulnerable or who have not elected to be communicated with by electronic means.
  - **Introducing an automatic opt-out to disapply costs and charges disclosures.** These will cease to apply to services provided to professional clients or eligible counterparties except for provision or investment advice and portfolio management. Firms will want
- **Suspension of best execution reports provided to investors.** It is conceivable that the European Commission may, in the event that this temporary suspension does not become permanent, push to amend the contents of the report and reintroduce this client-facing reporting requirement in a revised manner.
- **Introducing an exemption from requirements for firms to perform a cost-benefit analysis as part of suitability assessments for professional clients (although these may opt in) when switching products during an on-going relationship.** This change aims to reduce the administrative burden when wholesale clients change their investment strategy.
- **Exempting bonds with make-whole clauses from the MiFID II product governance regime to facilitate greater capital raising by making more plain vanilla corporate bonds available to retail investors.** The European Commission may also introduce a (much needed) exemption to clarify that non-complex bonds that contain make-whole clauses are not to be treated as within the scope of the application of the Packaged Retail and Insurance-based Investment Product (**PRIPs**) Regulation. These changes may prompt documentation amendments for existing products as well as client-facing disclosures to existing and new products.
- Introducing targeted amendments to the energy derivatives markets including:
  - **Amending position limits to apply to those agricultural commodity derivatives or commodity derivatives that are designated as significant or critical.** Details of these changes will be put forward in draft regulatory standards to be developed by ESMA.

20. See [here](#).

21. In a "proposal for a directive of the European Parliament and of the Council amending Directive 2014/65/EU as regards information requirements, product governance and position limits to help the recovery from the COVID-19 pandemic" available [here](#).

22. Details of which are available [here](#).

- **Reinforcing position management controls** to reduce divergences between trading venues. Further details of such measures will be published by ESMA.
- **Simplifying the “ancillary activity test”**, which refers to quantitative measures as to whether certain commodities trading ought to be considered an “ancillary activity” or subject to a licensing requirement.
- **Deleting the “same contract” concept and replacing it with a new cooperation arrangement amongst competent authorities.** Further details may follow from ESMA.
- **Revising and introducing a narrowly defined hedging exemption**, which would, subject to further details to be provided by ESMA, be available where, within a predominantly commercial group, one entity has been registered as a MiFID Investment Firm and trades on behalf of the group. An exemption on MiFIR/MiFID II position limits would also be introduced for financial and non-financial counterparties for positions resulting from transactions undertaken to fulfil mandatory liquidity provisions.
- **Introducing certain Prospectus Regulation reliefs and an “EU Recovery Prospectus”<sup>24</sup>**, which is a short-form prospectus for companies raising equity capital that have a track record<sup>25</sup> of at least 18 months on regulated markets or a SME Growth Market. This new form of “temporary prospectus”, which is valid for 18 months, aims to be easier for companies to produce and easier for investors to read as it will have a total maximum of 30 pages, and thus will be easier for NCAs to scrutinize under the existing fast-track approval process of five business days. The EU Recovery Prospectus aims at facilitating equity capital raising. Concurrent to the introduction of this new document type, a second set of targeted amendments to the EU’s Prospectus Regulation framework aims to facilitate fundraising by banks in financing the recovery of the real economy. The other Prospectus Regulation reliefs include amendments that:
  - regulate when a supplement to a prospectus must be supplemented and state that financial intermediaries are required to contact investors when the supplements are published; and
  - help smaller credit institutions when raising additional funds on a regular basis by allowing them to do so without the need to issue a new prospectus each time additional funds are raised.
- **Creating a framework for simple, transparent and standardized (STS) balance sheet synthetic securitizations<sup>26</sup>, as well as amendments to the EU Securitization Regulation<sup>27</sup> and the corresponding CRR Amendment Regulation<sup>28</sup> framework more generally to help the post COVID-19 recovery.** In summary, the package of amendments aims to increase the use of

The European Commission has also proposed to amend the MiFIR/MiFID II regime on energy derivatives markets, as well as put forward a public consultation (which closes on September 4, 2020) on Commission Delegated Directive 2017/593<sup>23</sup> to improve the framework and rules on research for small and mid-cap issuers and on fixed-income instruments, including consultation on the “research unbundling” exception under the proposed new amended regime. Each of these targeted amendments aim to help drive the post COVID-19 recovery.

23. Details and the proposed amendment to the Commission Delegated Directive is available [here](#).

24. In a “proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) 2017/1129 as regards the EU Recovery Prospectus and targeted adjustments for financial intermediaries to help the recovery from the COVID-19 pandemic” available [here](#) and the accompanying [Annex](#) setting out the minimum information to be included in the EU Recovery Prospectus.

25. This requirement also seeks to take advantage of the fact that, being listed, issuers already have experience with capital markets and are subject to comprehensive disclosure requirements, such as under the Transparency Directive or the Market Abuse Regulation.

26. Details of which are set out in a “Report from the Commission to the European Parliament and the Council on the creation of a specific framework for simple, transparent and standardized synthetic securitization, limited to balance-sheet synthetic securitization” available [here](#).

27. As set out in a “proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) 2017/2402 laying down a general framework for securitization and creating a specific framework for simple, transparent and standardized securitization to help the recovery from the COVID-19 pandemic” available [here](#).

28. Details of which are set out in a “proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards adjustments to the securitization framework to support the economic recovery in response to the COVID-19 pandemic” available [here](#).

securitizations to drive the European recovery by enabling banks to expand their lending and free up their balance sheets of non-performing loans and exposures (**NPLs**)<sup>29</sup>, as well as in respect of lending and securitization of SME loans. These measures, as well as the proposal to create a specific STS framework for on-balance sheet securitization (including the allowance of some utilization of excess spread and lower capital requirements to the senior tranche of STS synthetic securitizations), build upon the EBA's extensive preparatory work undertaken during 2019 and 2020<sup>30</sup> and breathe new life into the market that the CMU 1.0 flagship efforts of the EU Securitization Regulation and corresponding CRR Amendment Regulation sought to reform and simplify. Provided that certain new rules are met, eligible STS synthetic securitizations may be grandfathered under the new targeted framework. The European Commission will likely introduce further reforms, including taking account of published recommendations in the HLF Report as well as those pending in the CMU 2.0 Action Plan.

- **Introducing new powers under the EU Benchmarks Regulation (BMR) to set a statutory replacement rate.**<sup>31</sup> The EU's BMR legislation, when introduced, did not envisage a mechanism for the cessation of certain interbank offer rates (**IBORs**) and the difficulties this poses for certain financial contracts and instruments referencing IBORs at the date of their cessation. Welcomingly, notably for "difficult to amend" contracts and instruments, the targeted changes empower the EC, in respect of entities that are subject to the BMR, to designate a statutory reference rate at its discretion, in line with best practices/recommendations of relevant working groups. While this is welcome, this power (provided it is even used) **only** applies to LIBOR-denominated contracts (and the EC will align efforts with recommendations for all USD LIBOR tenors that are to be issued by the Alternative Reference Rate Committee (ARRC) in the United States). Relevant market participants still will need to step-up their IBOR transition efforts to meet the 2021 deadlines.

The comprehensive set of measures undertaken to advance CMU 2.0, including through the EU Capital Markets Recovery Package as an interim step ahead of the September 2020 scheduled CMU 2.0 Action Plan, are a bold move in the right direction if they can be rapidly implemented.

### Outlook and next steps

Following the conclusion of the consultation process on the EU Capital Markets Recovery Package, the European Commission will have to table these proposals for approval by the European Parliament and the Council, who may suggest further amendments prior to these becoming law. It is consequently unlikely that these proposals, or any measures flowing from the CMU 2.0 Action Plan, will become law in the EU prior to the end of the UK-EU transition period, currently set to expire on December 31, 2020, and it will be for the UK to decide as to whether to apply such measures to the set of EU legislation and regulation that it decides to retain. Firms may thus have to remain vigilant to the potential for conceptual gaps between the EU and UK's approach, irrespective of whether a deal (if any) on the future relationship as to financial services or a decision (if at all) on equivalence is reached and concluded by the EU and UK authorities.

Affected firms will therefore want to assess the impact of the individual changes and the changes as a whole, including those further amendments expected in the CMU 2.0 Action Plan, the full legislative review of the MiFID II regime in 2021 and the Securitization Regulation framework in January 2021. A number of these changes described above, as well as those scheduled, will likely translate into short-term compliance costs before yielding longer-term savings from resulting efficiencies. Firms will want to work with counsel to navigate these compliance obligations, their changes and take charge in making the most of relevant opportunities.

29. In addition to some welcome amendments to the capital treatment of NPL securitizations, the new EU proposal for NPL securitizations allows the 5% risk retention requirement to be calculated on the discounted value of the pool of NPLs instead of their nominal value and for such retention to be held by managers.

30. See in particular following report from the EBA available [here](#).

31. See statements [here](#).



If you would like to discuss strategic options in respect of the consultations or the impact any of the items mentioned above, in particular how to plan ahead for any operationalization in meeting compliance requirements and/or in respect of impact on policies and procedures or how these priorities may affect your business or your clients more generally, please contact our **Eurozone Hub** key contacts.



## Key contacts



**Dr. Michael Huertas**  
Partner, Co-Head Financial  
Institutions Regulatory Europe  
D +49 69 45 00 12 330  
[michael.huertas@dentons.com](mailto:michael.huertas@dentons.com)



**Dr. Holger Schelling**  
Partner  
+49 69 45 00 12 345  
[holger.schelling@dentons.com](mailto:holger.schelling@dentons.com)

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