CMU Policy Update

April-May

HIGHLIGHTS

- ECB & ESAs: ESMA publishes technical advice on prospectus disclosures – 3 April
- European Commission: new proposal for a venture capital fund-of-funds – 10 April
- Council: EU finance ministers discuss CMU priorities for 2019 – 27 April
- European Commission: new proposals on sustainable finance and facilitating SME listings – 24 May
- European Parliament: adopts its first positions on sustainable finance – 29 May

European Commission

Commission proposes venture capital fund of funds – 10 April

The European Commission has set up pan-European venture capital funds-of-funds, called VentureEU.

VentureEU aims to use public money in a way to better attract substantial amounts of private investment from investors who are not currently investing in European venture capital due to the lack of appropriate vehicles. The Commission believes that funds-of-funds, acting as intermediaries, can bridge the gap between large institutional investors and smaller venture capital funds. In this way, the Commission maintains they can provide access to larger pools of international capital and so enable more European SMEs and start-ups to be financed as they grow and get support for longer periods of time.

VentureEU itself consists of a total of six funds. Benefitting from investments totalling €410 million from the EU that crowd in private investors, the Commission expects that these six VentureEU funds will raise up to €2.1 billion of public and private investment. The funds will invest around 25% of the target size of smaller venture capital funds, which will in turn raise additional capital from other investors, resulting in an estimated €6.5 billion of new investment in innovative start-ups and scale-ups across Europe and beyond, the Commission assesses.

The VentureEU funds will cover projects in at least four European countries each. The smaller investee funds will help finance SMEs and mid-caps from a range of sectors, such as digital, life sciences, medical technologies, and resource and energy efficiency. Around 1,500 start-ups and scale-ups are expected to gain access to this funding.

Commission publishes roadmap for next steps of prospectus reform – 24 April

The European Commission has published a roadmap outlining the next steps for the prospectus reform.

The Roadmap appeared a few weeks after ESMA published its technical advice to the Commission for the detailed measures concerning the format and disclosure requirements of the new prospectus regime – including the EU Growth Prospectus (EUGP) intended for smaller listed entities. See article below in the ECB & ESAs section for further details on ESMA's technical advice.

The Commission Roadmap elaborates on the next steps that it will take in proposing the detailed disclosure proposals, on the basis of ESMA's advice. The Commission proposal is expected for before the summer break. Overall, it appears that the Commission is content with ESMA's technical advice – at least as far as the EUGP is concerned. However, slight tweaking around the edges will still be possible, to a degree allowed by the Prospectus Regulation's political mandate.

After the Commission publishes its technical measures, the European Parliament and the Council will have two months to raise any objections. Should they choose not to object, the measures will be adopted automatically.

Commission proposes first concrete sustainable finance measures – 24 May

The European Commission has published its first legislative proposals on sustainable finance. The proposals aim to improve investors' access to reliable information. In this way, they are hoped to lead to more investment opportunities that will foster the transition to a more sustainable economy.

The package of proposals includes the following items:

- taxonomy: establishing harmonised criteria to determine if an economic activity is sustainable/green
- investors' duties: disclosures for sustainable investment and sustainability risks, and how ESG factors should be factored into institutional investors' decision-making
- benchmarks: establishing low carbon benchmarks and positive carbon impact benchmarks

For all of the proposals, the European Parliament and the Council will co-legislate on an equal footing. Further details are below.

Taxonomy

The proposal for a unified EU classification system sets harmonised criteria which will allow to determine if an economic activity is sustainable/green. This will help to inform economic actors and investors in their decision-making and will serve as a basis for the establishment of EU standards and labels for financial products. The proposal:

- lays out conditions for identifying environmentally-sustainable economic activities
- defines the six EU environmental objectives to which economic activities will have to contribute to be considered eligible
- allows the Commission to establish technical screening criteria and frames how these criteria would have to be defined

The Commission will draw upon the work of the technical expert group on sustainable finance to further define what qualifies as 'sustainable'. This expert group is currently being set up. The Commission is aiming for 2022 to have the EU environmental taxonomy completed.

Investor duties and disclosures

The proposal for a Regulation on the institutional investors' duties (asset managers, insurance companies, pension funds, investment advisors) sets out the measures for how the ESG factors should be factored into their decision-making. Also, institutional investors would have to show-case how they align their investment strategies with ESG objectives and disclose how they comply with these duties.

The proposed regulation will apply to the following entities:

- asset managers
- institutional investors:
  - insurance undertakings regulated by Solvency II
  - occupational pension funds (the institutions for occupational retirement provision directive (IORP II)
- insurance distributors regulated by the insurance distribution directive (IDD)
- investment advisors and individual portfolio managers regulated by Markets in financial instruments directive (MiFID II)

The Commission's proposal requires disclosure of:

- the procedures that financial actors have in place to integrate ESG risks into their investment and advisory process
- the extent to which ESG risks are expected to have an impact on the returns of the product or service provided, irrespective of whether or not sustainable investment objectives are pursued

In addition, if asset managers or institutional investors claim that they pursue a strategy with sustainability investment objectives, they will have to provide information on how they adhere to those sustainability objectives in their investment decisions. This includes the disclosure of the sustainability or climate impact of their products and portfolios.

Benchmarks

Another proposal the Commission is putting forward is on the low-carbon benchmarks with a suggestion for two types of benchmarks: low-carbon benchmarks and positive-carbon impact.

Benchmark providers are free to provide a full spectrum of low-carbon benchmarks, which will set a higher ambition to meet climate-related objectives. Where no EU low-carbon benchmark or positive-carbon benchmark is available, they will have to provide a detailed explanation on how it is ensured that they continue to target reducing carbon emissions. This will provide investors with a reliable tool to pursue low-carbon investment strategies.

Better advice to clients on sustainability

Finally, the Commission is also proposing changes to MiFID II and the Insurance Distribution Directive (IDD) to tailor investment advice towards sustainable finance goals. Currently, MiFID II and IDD require investment firms and insurance distributors to obtain the necessary information about clients' investment objectives prior to providing products. However, for now firms do not always assess investors' non-financial preferences, such as their preferences concerning environmental and social impacts of the investment.

Commission proposes measures to incentivise and facilitate SME listing – 24 May

The European Commission also published its long-awaited proposals to alleviate regulatory requirements for small companies listed on SME Growth Markets (SME GMs).

The Commission's objective is to attract new issuers to SME dedicated markets. It wants to achieve this by cutting red-tape on SME GMs, and fostering the liquidity of publicly-listed SME shares.

The Commission's listed SMEs package consists of two proposals:

- regulation amending the Market Abuse Regulation (MAR) and the Prospectus Regulation. This is the main bulk of the Commission's measures
- Draft delegated regulation making additional relevant technical adjustments to MiFID II

The Commission emphasises that these proposed changes will only constitute a first step to enhancing SME listings. Most of the measures aim to alleviate red tape related to insider lists, management transactions, private placements etc., incentivise more Multilateral Trading Facilities (MTFs) to register as SME GMs, and improve the liquidity for SME shares.

Of additional interest, the Commission proposes that issuers that have been listed on a SME GM for three years and want to transfer to a regulated market only have to issue a simplified prospectus. This simplified prospectus is the alleviated secondary issuance prospectus from the Prospectus Regulation.

Furthermore, under this simplified prospectus regime, the issuer would have to prepare its latest financial statements using the IFRS, instead of local GAAP which companies listed on SME GMs normally may use.

As with the sustainable finance measures, these proposals will be co-legislated on by both the European Parliament and the Council on an equal footing. The Commission will, undoubtedly, seek to conclude both files before the end of its current term in spring 2019.

European Parliament

ECON hearing with Vice-President Dombrovskis discusses CMU initiatives – 17 May

The ECON Committee of the European Parliament has held a public hearing with the Commission's **Vice-President Dombrovskis** in charge of the CMU.

With a total of 10 CMU proposals now on the table, the Vice-President urged the Parliament to complete the many files on the table before the end of their mandate in spring 2019. He hoped that ECON Committee would finalise its position on the Pan-European Personal Pension Product (PEPP) before the summer break, and re-iterated that the Commission will aim to finalise at least the proposals on the European Supervisory Authorities (ESAs), distribution of cross-border funds and crowdfunding during its current mandate.

ECON debates PEPP proposal – 28 May

The ECON Committee has held a debate on the Pan-European Personal Pension Product (PEPP) proposal and its tax treatment. Both files are led by the MEP **Sophia in 't Veld (ALDE/NLD)**.

The majority of MEPs who took the floor agreed that the PEPP Regulation is required to provide pension products in particular for EU citizens who may live and work across several member states in their lifetime. Moreover, several members called for the legislation to ensure that PEPPs would constitute bona fide pension products. One issue of contention which emerged between the political Groups concerned the question of who would grant authorisation for PEPPs.

For **Brian Hayes (EPP/IRL)**, national authorities are best placed to grant authorisation for PEPP provision. On compartments, Mr. Hayes maintained that it is too burdensome to expect providers to offer compartments for all EU member states. However, if a PEPP saver moves to another member state, they must be offered options to continue saving. If a PEPP provider cannot offer this, the PEPP saver should be able to change to another product in that member state free of charge.

Renato Soru (S&D/ITA), for his part, agreed that national authorities are better informed than the European Supervisory Authorities (ESAs). However, the ESAs should also receive a large role as it will be cross-border system. On compartments, he seemed to agree with the EPP position. He believed that specific agreements could allow for an analogous set up without having compartments in each member state. If a saver moves to another member state, they must have guarantees that they can choose a provider in the new country with no additional costs.

Finally, **Ashley Fox (ECR/UK)** maintains that the role of the national authorities should be made stronger. On the tax treatment, he reminded that taxation remains a matter of national sovereignty, and the European Parliament has no role to play in this.

The ECON Committee vote will take place on 11 July. A total of 914 amendments have been tabled for Ms. in 't Veld's draft report. The amendments are accessible here, here and here.

European Parliament adopts position on sustainable finance – 28/29 May

The European Parliament has adopted its first position on the sustainable finance agenda by approving a draft report prepared by the MEP **Molly Scott Cato (Greens-EFA/UK)**. The report was adopted in by Plenary 455 votes in favour, 195 against and 12 abstentions.

The report is legally non-binding and does not commit the European Commission or member states to any particular course of action. However, it establishes the Parliament's initial positions on key sustainable finance files and as such, will influence the MEPs' work on tangible Commission proposals currently on the table or yet to come.

Highlights from the debate

Prior to the vote, the MEPs exchanged views on the draft report as tabled ahead of the vote. The following are some of the highlights from the discussion:

- **Molly Scott Cato (Greens-EFA/UK):** welcomed the cross-Group support for the sustainable finance agenda. She emphasised the draft report's alternative approach to taxonomy from that proposed by the Commission. She believes that her proposals will better allow investors to shift their asset holdings gradually, thus enabling an orderly transition. Thus, the risk posed by stranded carbon assets could be avoided, Ms. Scott Cato argued. The draft report proposes extending the stranded asset concept to include fundamental ecological systems and services. Finally, she called for the inclusion of ESG considerations into ECB's and European Investment Bank's (EIB) investment policies
- **Sirpa Pietikäinen (EPP/FIN):** stated that sustainable finance is the biggest change in the financial market since the application of general accounting and auditing principles. Fostering sustainable finance is a matter of having a review of financial regulation and perverse incentives
- **Julie Ward (S&D/UK)**, for her part, welcomed the focus of the report on green finance and highlighted the central role of collaborative economy actors. She believed more focus should be on social entrepreneurship, not simply in conventional forms of entrepreneurship

- **Violeta Bulc, European Commission:** expressed her satisfaction about the consensus in the Parliament on sustainable finance. This, she believes, will make it easier for Commission's recent proposals (see article above) to be adopted swiftly
  - Re-iterated that in the coming weeks the Commission will establish a Technical Expert Group (TEG) that will further work on developing a EU classification for sustainable activities (taxonomy) standards for green bonds and sustainability metrics
  - There is still some work ahead to address some of the MEPs' recommendations from the draft report. For instance, the Commission is evaluating mandatory reporting requirements to make sure they provide the right information to market participants, thus enabling them to assess companies' long-term value creation and sustainability risk management. Further clarification of the role of European Supervisory Authorities (ESAs) in this process is also needed, Ms. Bulc concluded

Council

EU finance ministers discuss economic convergence and Capital Markets Union during informal meeting in Sofia – 27 April

EU finance ministers have discussed CMU priorities for 2019 at their informal meeting in Sofia.

Reportedly at the meeting, several ministers confirmed their support for three priorities: reinforcing EU supervision and powers of ESMA, simplifying prudential rules and harmonising insolvency regimes, and setting up new products such as the pan-European personal pension product (PEPP). These priorities were also identified by the Brussels-based think tank, Bruegel, as the next priority steps to be taken for the completion of the CMU.

On insolvency is concerned, some finance ministers pointed out that this is rather a matter for justice ministers. Commission **Vice-President Dombrovskis** apparently proposed, as a result, a joint meeting between justice and finance representatives of the Council.

On reforming the European Supervisory Authorities (ESAs), visible differences between member states remained at the discussion, although reportedly these are now less marked than last year. Luxembourg remains staunchly opposed to the proposal, however.

Inevitably, the ministers also discussed Brexit. They recognised that Brexit reinforces the need to complete the CMU in order to foster capital markets in the EU 27, to compensate for losing access to the City, and to find a way to maintain close links with London without undermining European prudential rules or endangering financial stability.

ECB & ESAs

ESMA publishes draft technical advice on prospectuses – 3 April

ESMA has published its technical advice to the Commission on the new prospectus rules. This advice includes ESMA's proposals for the disclosure, format and content provisions of both the base prospectus as well as the EU Growth Prospectus (EUGP) – a prospectus designed for small listed entities on SME Growth Markets.

On the EUGP specifically, ESMA has made some concessions further alleviations in comparison to its earlier draft advice, but in many areas it stands its ground.

For example, for the EUGP Securities Note ESMA has introduced practically no amendments whatsoever. However, for the EUGP Registration Document ESMA proposed further alleviations such as removing the obligation to include information on the regulatory environment. Furthermore, ESMA will produce in the future further guidance on the risk factors.

In terms of next steps, the European Commission will propose a delegated act on the basis of ESMA's recommendations (see article above).

ESAs warn against risks for EU financial markets: Brexit, asset repricing and cyber-attacks key risks – 12 April

The three ESAs – ESMA, EBA and EIOPA – have warned against major risks that may undermine the functioning of EU's financial markets: Brexit, asset re-pricing and cyber-attacks. The ESA report also reiterate their warning to retail investors investing in virtual currencies and raises awareness for risks related to climate change and the transition to a lower-carbon economy.

They put forward recommendations to alleviate these risks, such as:

- Brexit: for all market players and regulators to consider timely mitigation actions to prepare for the UK's withdrawal from the EU – including possible relocations and actions to address contract continuity risks
- Cyber security: financial institutions should improve fragile IT systems, explore inherent risks to information security, connectivity, and outsourcing. To support this, the ESAs will continue addressing cyber risks for securities, banking and insurance markets and monitor firms' use of cloud computing and potential build-up of cyber risks
- Climate change: the ESAs recommend financial institutions to consider sustainability risk in their governance and risk management frameworks and to develop responsible, sustainable financial products. Moreover, supervisors should enhance their analysis of potential risks related to climate change for the financial sector and financial stability

ESMA study shows impact of short-selling disclosure on investor behaviour – 13 April

According to a recent study by ESMA, the public disclosure of net short positions in EU shares influences investors' behaviour. This conclusion is based on an analysis of net short positions reported under the Short-Selling Regulation (SSR).

The SSR data shows that there were 210,341 net short positions reported from January 2013 to December 2016. These net short positions related to over 2,000 European shares, the majority being UK and German securities. The ESMA analysis reveals that around 1,000 different investors are active in EU shares, with the large majority of them being domiciled in the US (40%), the UK (30%), and only 15% in the rest of EU. In addition, short-selling activities appear highly concentrated, with 150 investors accounting for more than 80% of all reported short positions.

The ESMA study also provides evidence that investors seem to avoid crossing the public disclosure threshold in order to keep their strategies secret. The evidence gathered also indicates that disclosure to the public of significant net short positions might, as a side effect, reinforce herd behaviour in short-selling activities.

International

'ROBO' FINANCIAL ADVICE CATCHES EYE OF UK REGULATOR – 23 May

According to the Financial Times, the UK's Financial Conduct Authority (FCA) has accused automated investment advice providers of not giving customers enough warnings about risk, being unclear about charges and failing to understand customers' needs and financial situations.

FCA maintains that many of the companies fail to ask vital questions about customers' finances, including their debt levels and outgoings. Since 2016, FCA has allowed companies offering financial advice to ask customers fewer questions to speed up the process, but it is now worried about the risks that might result, Financial Times reports.

MEP Questions & Answers

Green finance and danger of green bubble – 18 April

The European Commission has replied to a question asked by the MEP **Jérôme Lavrilleux (EPP/FRA)** with regard to green finance and the danger of a "green bubble".

In his question, Mr. Lavrilleux expresses concern over a proposal by the French Banking Federation (FBF). FBF suggests creating a 'green supporting factor', a sort of prudential bonus for banks dealing with sustainable finance which would reduce their capital requirements and which has met the Commission's approval. Mr. Lavrilleux argues that this proposal is risky from a financial stability perspective, and asks the Commission what its views on the proposal are, and to what conditions the Commission would subject the measure.

In his reply, **Vice-President Dombrovskis** states that the Commission supports work on a green supporting factor. He maintains that by reducing the costs of certain loans, a 'green supporting factor' could provide incentives for investments that are good for the climate. However, any measures would need to be justified from a risk and financial stability perspective, and they would need to be carefully calibrated. The scope of such measures will need to be coherent with a future EU taxonomy on sustainable activities, which the Commission is currently working on.

Events

- 19/06/2018, ***Digital Day** – **Opportunities in innovation***, Accountancy Europe, Brussels. Source
- 19/06/2018, ***Sustainable Finance Action Plan***, Financial Future, Brussels. Source