Setting in motion the Capital Markets Union

María Abascal | Lucia Pacheco | José Carlos Pardo | Pilar Soler

On 30 September the European Commission released an Action Plan on Building a Capital Markets Union (CMU), after consulting with the public last February. This document provides a more detailed roadmap until 2017, as well as specific proposals in some key areas such as securitization and covered bonds. In 2017, the Commission will take stock of the progress achieved and shed more light on the steps to be taken until 2019. The CMU is Europe's new flagship project, aimed at creating a deeper, broader and more integrated capital market under a multi-pronged strategy. In the end it will contribute to completing the Single Market and enhancing economic growth and investment.

The CMU project is a move of the European leaders to tap the full potential of capital markets to the benefit of enhanced prosperity, stronger economic growth and a deeper Single Market. The Green Paper released last February[1] identified the barriers to capital market integration and outlined the measures to tackle them, covering several market segments as well as cross-sector action. Although it lacked concretion on the timeline and specific steps, it has successfully engaged the industry in the discussions and has provided with some useful conclusions that are clear in the Commission's Action Plan. In particular, the industry has highlighted the important role to be played by banks in CMU and has also drawn the attention of European leaders to the need of striking the right balance between promoting economic growth and safeguarding financial stability. The Action Plan released now marks the roadmap towards a truly single European capital market.

Overview

The action plan is built in six main blocks:

1. **Finance for innovation, start-ups and non-listed companies**. It is aimed at increasing the funding sources that businesses and SMEs can access in an early stage of their growth. It includes next steps to be accomplished by the Commission regarding: i) crowd-funding, ii) venture capital, iii) overcoming information barriers for SMEs, iv) loan originating funds and v) private placements.
2. **Easing the access to public markets for SMEs**. The Commission will act on: i) the Prospectus Directive, modernizing it and creating a proportionate regime for SMEs, ii) facilitating access to public markets by SMEs, addressing existing regulatory barriers, iii) corporate bond market, with focus on liquidity improvement and iv) debt-equity tax bias.
3. **Investing for the long term, infrastructure and sustainable investment.** A key driver of long-term investments is the regulatory framework which has already been revised in Solvency II for insurance companies and is also being reviewed in the Capital Requirements Regulation for banks. Moreover, the Commission is initiating a comprehensive review of the cumulative impact of financial regulation.
4. **Fostering retail and institutional investment.** Aimed at removing the barriers for retail investors' savings, the Commission will publish a Green Paper on a single Retail Financial Services and Insurance and will also undertake an assessment to improve the access of retail investors to suitable

[1] For more information see BBVA Research Flash: https://www.bbvaresearch.com/wp-content/uploads/2015/02/Flash-Libro-Verde-CMU_190220151.pdf

products. The Commission released a roadmap at the beginning of September[2]. Regarding institutional investment, work will be mainly focused on addressing the regulatory framework of long-term investments (ELTIFs and infrastructure) and on the existing barriers to the cross-border distribution of investment funds.

5. **Leveraging banking capacity to support the wider economy.** The action plan highlights the importance of banking funding for businesses and SMEs and accordingly the Commission will review banking regulation to ensure an optimal balance between managing risks and enabling growth. Credit Unions are also recognized as important instruments in supporting growth. The Commission will study the possibility to allow Member States to authorize Credit Union not subject to CRD regulatory framework in order to eliminate obstacles and to permit all Member States to benefit from these Credit Unions.
6. **Facilitating cross-border investing**. With the objective of eliminating barriers and facilitating the diversification of geographical portfolios of investors, the Commission will work on: i) providing legal certainty for cross-border investments, ii) removing national barriers iii) promoting financial stability and supervisory convergence and iv) easing international investment.

Timeline

The Action Plan provides a timeline for the accomplishment of the key action points to achieve a Capital Markets Union. It proposes starting with initiatives that are already at a more advanced stage while leaving more far-reaching reforms (referred to, among other things, tax or insolvency regimes) to a later stage. Besides, the Commission intends to publish a report in 2017 assessing the progress achieved and signalling the way forward.

Figure 1
Main action points in CMU timeline

Detailed plan		High level plan	
2015	**2016**	**2017**	**2018**
Ongoing: • Infrastructure investments: CRR review • Credit Unions • Supervisory convergence **Q3 (already launched)**: • Securitizations • Cumulative impact of financial regulation • Covered bonds • Venture Capital • Infrastructure investments: amendments to Solvency II **Q4**: • Prospectus Directive • Green paper on retail financing services and insurance	**Q1**: • Report on crowd-funding **Q2**: • Pan-European venture capital fund-of-funds • Strengthen feedback on declining SMEs credit applications • Cross-boarding distribution of investment funds • ESAs funding and governance **Q3**: • Revision of EuVECA and EuSEF legislation • Strategy to support capitals market capacity **Q4**: • Loan origination by funds • Debt-equity-bias • Assessment of policy framework for European personal pensions • Barriers for free movement of capital • Business insolvency	• Further action on venture capital • Further action on overcoming information barriers • Further action on access to public markets • Cross- boarder investing and tax barriers • Revision of macroprudential framework	• Retail Investment products • Further action on institutional investors and fund managers

Source: BBVA Research based on European Commission's Action Plan

2 http://ec.europa.eu/smart-regulation/roadmaps/docs/2015_fisma_031_other_outside_cwp_green_paper_retail_en.pdf

Immediate priorities

Within the road map, the following topics are identified as key action points to be studied in the short term:

- **Legislative proposals on securitization**.[3] Last February, the Commission launched a consultation on an EU framework for simple, transparent and standardized securitization with the objective of creating a sustainable market for high quality securitization. These high quality securitizations would receive lower capital requirements. The Commission has finalized a package of two legislative proposals: i) a Securitisation Regulation that will apply to all securitisations in order to create a general and uniform framework applicable to EU transactions. This framework includes: common definitions, due diligence, risk retention and transparency rules together with the criteria to identify Simple, Transparent and Standardised ("STS") Securitisations, and ii) a proposal to amend the Capital Requirements Regulation (CRR) making the capital treatment of securitisations for banks and investment firms more risk-sensitive and able to reflect properly the lower risks of STS securitisations. Adjustments in the prudential treatment of securitisations for insurers and to prudential treatment for liquidity purposes for banks and investment firms will come at a later moment.
- **Call for evidence on the cumulative impact of financial legislation**[4]. As a consequence of the great amount of new regulations that have recently been implemented or are to be adopted in the short term, the Commission has launched a call for evidence in order to prevent inconsistencies, duplicities and unintended consequences of this new regulatory framework. This consultation will run until January 2016.
- **Consultation on covered Bonds**[5]**.** The Commission has launched a consultation on a pan-European framework for covered bonds that would reduce the existing fragmentation in this market derived from the significantly different legal frameworks and supervisory practices across Member States. A standardised framework for covered bonds would allow to achieve deeper, more liquid and accessible markets, especially across borders. The consultation paper explores two possibilities for the reform agenda: i) promoting a voluntary convergence of Member States' laws or ii) developing legislation at EU level. The consultation will run until January 2016.
- **Amended rules to promote infrastructure and long term investments under Solvency II**[6]: The insurance industry plays a major role in providing long-term finance. In order to maintain and promote this condition of long-term funders, the Commission is revising the prudential treatment of insurers' investment in infrastructure projects. These amendments mainly affect: i) infrastructure projects by the constitution of a new asset category ("qualifying infrastructure investments") that will require lower capital, ii) investments in European Long -Term Investment Funds (ELTIFs) and equities traded in multilateral trading facilities, that will now be subject to the same capital charges than equities traded on regulated markets and iii) unlisted equities, to which a transitional measure will be extended to prevent a sudden withdrawal from equity.
- **Consultation on venture capital**[7]. Given the importance of venture capital as a fund provider for businesses and SMEs, the Commission is seeking further information on the European Venture Capital Funds (EuVECAs) and European Social Entrepreneurship Funds (EuSEFs) regulation to identify targeted changes that could help to improve the development and performance of these

[3] http://ec.europa.eu/finance/securities/securitisation/index_en.htm
[4] http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/index_en.htm
[5] http://ec.europa.eu/finance/consultations/2015/covered-bonds/index_en.htm
[6] http://ec.europa.eu/finance/insurance/solvency/solvency2/index_en.htm
[7] http://ec.europa.eu/finance/consultations/2015/venture-capital-funds/index_en.htm

funds. For this purpose, the European Commission has launched a consultation that will run until January 2016 covering, among others the following issues: i) management and market of EuVECAs and EuSEFs, ii) portfolio threshold, iii) investors in EuVECAs and EuSEFs funds, and iv) set up of these funds.

Assessment

The CMU project is very ambitious and therefore the Action Plan covers a wide range of actions. Still, the identification of quick wins where significant progress can be achieved is welcome. The Action Plan that has just been released is a move in the right direction, as it strikes a right balance between the need of fostering economic growth by means of revitalised capital markets and the imperative to safeguard financial stability.

The CMU project is essentially long-term, but the early initiatives that have been unveiled can create the necessary political momentum to set the project in motion. In particular, the proposals on covered bonds and securitisations can help leverage the capacity of banks to finance the economy, which is of utmost importance to facilitate financing the desired economic recovery.

In the whole CMU project, and even more importantly for the covered bonds market, the harmonisation can help reducing fragmentation and promoting a level playing field in Europe. Nevertheless, it is worth noting that best practices should be conserved and promoted at the EU level.

Besides, the call for evidence on the cumulative impact of financial regulation is a very positive initiative, as it will help to ensure coherence of the extensive new regulatory framework and will help to avoid unintended consequences of new regulations. This last point is especially important given the recent debate on the possible negative consequences that new regulatory requirements are posing on liquidity in financial markets.

It should also be noted that there are certain on-going EU initiatives that do not favour the aim of the CMU of unifying the workings of the capital markets across all EU countries and boosting growth and investment. For example, the introduction of a financial transaction tax under enhanced cooperation will create an important distinction between the financial markets of 11 countries and the rest within the EU. Moreover, the banking structural reform is likely to affect negatively to the correct functioning of financial markets, due, mainly, to its impact in market making activities.

DISCLAIMER