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The Action Plan for a Capital Markets Union – Part 1: Aims, Priorities and Measures

On 30 September 2015, the European Commission adopted an action plan to achieve a European single market for capital for the 28 Member States (the Action Plan). On the same date, the Commission also launched some of the measures listed in the Action Plan.

This briefing, the first in a series of updates on the Capital Markets Union (CMU), provides a brief outline of the priority areas that the Commission has chosen for focussed attention in its plan to build a CMU. It also discusses the measures that are required to achieve the Commission's aim of strengthening and integrating the capital markets in Europe with a view to benefitting the wider European economy.

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The Driving Force

The free movement of capital, one of the “four freedoms” underlying the European Single Market, is a fundamental factor driving the process of building a CMU. It is necessary for the integration of financial markets and services, and consequent growth and competition in Europe. Barriers to the free movement of capital remain, however, in the form of impediments limiting companies (Small and Medium-Sized Enterprises (SMEs) in particular) from raising equity and debt finance. In addition, capital flows in Europe have been affected by the continuing deleveraging in the European banking sector. The heavy reliance on bank lending in Europe has meant that the post-crisis reduction in traditional bank lending has produced a funding gap. It is anticipated that the CMU will help to strengthen the role of the capital markets and broaden the availability of diverse sources of finance that complement bank lending, which will continue to be an important source of financing in Europe. By deepening financial integration, the CMU will make the financial system more stable.

The Priority Areas

CMU is a long-term project. Europe's requirement for renewed economic growth following the global financial crisis is, however, immediate. The Action Plan identifies in its introduction certain priority areas that will be the focus for building the CMU. The free movement of capital is the factor that underpins the five priority areas described below, which have also been shaped by the outcome of the Green Paper on the CMU published by the European Commission in February 2015:

1. Providing more funding choices for Europe's businesses and SMEs
2. Ensuring an appropriate regulatory environment for long term and sustainable investment and financing of Europe's infrastructure
3. Increasing retail and institutional investment
4. Enhancing the capacity of banks to lend
5. Bringing down cross-border barriers and developing capital markets for all 28 Member States

The Priority Actions

Sections 1 to 6 of the Action Plan set out the priority actions needed to achieve progress in the priority areas described above. We have set out the priority actions, together with indicative timelines for measures and proposals where relevant, in the attached Action Plan Outline.

First Stage Measures

On 30 September 2015, together with the Action plan, the Commission also launched certain measures that were identified in the Action Plan. These measures, which seek to progress the priority areas listed above, are as follows:

A review of the EU regulatory framework for financial services

On 30 September 2015, the Commission launched a “call for evidence” inviting evidence on the issues concerning the EU regulatory framework for financial services.

It is acknowledged in the call for evidence that a large amount of rules concerning financial institutions, markets and infrastructures were introduced following the financial crisis in order to strengthen the EU financial system. The onus, according to the Commission, should now be on understanding the combined impact of those rules and establishing if they are interacting as they should.

In the call for evidence, the Commission focusses attention on identifying any rules or unnecessary regulatory constraints affecting the ability of the economy to finance itself and grow. Recognising the increasing diversity of financial and non-financial market players, the Commission questions whether the regulatory framework is still suitable for all parties and whether it has had any significant impacts on market liquidity or on consumer and investor confidence and protection.

The Commission also calls for evidence of any unnecessary or excessive regulatory costs and complexities or excessive reporting and disclosure provisions (either publicly or to supervisory authorities) arising out of the regulations in the EU financial sector. In addition, with so many technological changes affecting the sector, the Commission seeks to establish if there are any outdated rules. Regulatory burdens also arise in connection with the need to update standard regulatory contracts, and the Commission seeks evidence in this respect and also in relation to any new barriers to entry for new market players.

The Commission recognises that the rules on banking, insurance, asset management and other financial areas are not always interacting as intended, and it therefore seeks to understand if there are any unintended consequences, overlapping requirements, significant regulatory gaps or inconsistencies of definitions that need to be addressed.

To the extent that the Commission is able to take action successfully where needed or identified, this will have a beneficial impact on the coherence of the EU financial services regulatory environment and the economy in Europe as a whole.

New rules on Solvency II treatment of infrastructure projects

In keeping with the Commission’s stated priority aim to ensure an appropriate regulatory environment for long-term and sustainable investment and financing of Europe’s infrastructure, the Commission has made amendments to the Solvency II Delegated Regulation. The amendments alter the regulatory capital treatment of investments in infrastructure projects by insurers and European long-term investment funds. The main amendment creates a distinct asset class of “qualifying infrastructure investments”. These will benefit from lower capital charges in respect of debt and equity investments made in these types of infrastructure projects. Relevant investors will, as a result, have more of an incentive to invest in infrastructure as an asset class, providing much needed capital to this sector.

Public consultation on venture capital and social entrepreneurship funds

A consultation on the review of the Regulation on European Venture Capital Funds (EuVECA) (No 345/2013) and the Regulation on European Social Entrepreneurship Funds (EuSEF) (No 346/2013) is being run by the Commission

until 6 January 2015. Pursuant to these regulations, only small fund operators managing asset portfolios below EUR 500 million have the EuVECA and EuSEF passports available to them.

The aim of the consultation is for the Commission to collect feedback on the performance of these regulations so that it can propose measures (including amending the regulations without reducing investor protection) to encourage take-up of the two fundraising passports for venture capital and social entrepreneurship funds. Potential changes to the regulations could permit larger fund managers to market EuVECA and EuSEF funds with passports. Once again, the free movement of capital from investors into the real economy is the driving factor behind this consultation, which forms part of the Action Plan.

Consultation on covered bonds in the European Union

The Commission has published a consultation paper relating to the development of a pan-European framework for covered bonds. Replies must be submitted by 6 January 2016.

Covered bonds are debt obligations issued by credit institutions that are secured by a ring-fenced pool of assets known as a “cover pool” or “cover assets”. The use of covered bonds for long-term financing is well established in a number of EU Member States (in particular Germany), but they have been less predominant in others. The Commission has previously identified that the covered bond market in Europe is fragmented and typically organised along national lines, possibly as a result of the lack of common standards for all covered bonds in the EU. In the Consultation, the Commission refers to an earlier EBA Report that, according to the Commission, showed that national covered bond laws “*appear quite disparate in some key technical aspects and, accordingly, it cannot be said that there is a common “European” covered bond instrument or set of standards beyond some high level principles for prudential purposes.*”

The EBA subsequently recommended more convergence of national legal, regulatory and supervisory frameworks for covered bonds, as this fragmentation is a barrier to an integrated single market for capital. The Consultation, it is hoped, will help to identify the action required to improve the transparency and quality standards of covered bonds. The Commission will use the feedback to consider the reforms necessary to provide convergence of national laws and an integrated covered bond framework that will apply throughout Europe. This will benefit the players in the covered bond markets and the general economy.

Legislative proposals for a securitisation framework

The Commission is proposing a regulatory framework for securitisations which are simple, transparent and standardised (STS).¹ The framework includes a new draft regulation (the Securitisation Regulation) and a proposal to amend the relevant provisions of the Capital Requirements Regulation. The Securitisation Regulation proposes new rules relating to:

1. risk retention: including revisions to the CLO originator definition and the possibility of criminal sanctions and large fines for non-compliance
2. STS securitisations
3. due diligence, including retrospective provisions applicable to existing securitisations
4. disclosure, including obligations to disclose information to both investors and regulators

Securitisation has been one of the key bridges between the banking world and the capital markets world. The banking world creates income-generating assets that can be securitised, and arranges the issuance of notes which are purchased by investors in the capital markets world, who have capital to invest but do not have the infrastructure to originate the assets or arrange the issuance of notes.

¹ To review our previous alert on the proposals for a regulatory framework for STS securitisations, please click [here](#).

Efforts to rehabilitate the securitisation market following the global financial crisis are not new. Various regulatory and market initiatives have been created to make securitisation safer and attract investors back to the market. The most significant of these has been the requirement that those creating and selling securitisations should retain a portion of the risk of those securitisations. Other initiatives have focussed on the capital charges that investors in securitisations, who are subject to capital adequacy regimes, are required to adhere to if they are to invest in securitisations.

The securitisation initiative adopted by the Commission includes rules relating to risk retention but also focusses on the process of standardisation, pursuant to which simpler and more transparent securitisation products are differentiated from other more complex products. Standardisation might make the process of organising securitisations more prescriptive, but brings a far greater degree of stability and certainty to investors than has historically been the case. The emphasis on regulatory-driven due diligence and disclosure is also now resembling the regulatory approach that exists in respect of the OTC derivatives market under the European Markets Infrastructure Regulation (EMIR).

We will continue to publish updates, as part of our series on the CMU, that will each provide a more detailed review of specific initiatives. If you would like to learn more about the issues in this alert, please contact any of the attorneys listed below or your usual Ropes & Gray advisor.

For Action Plan Outline, click [here](#).