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CAPITAL MARKETS UNION

CMU Mid-Term Review Action Plan

Pilar Soler

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On June 8 the European Commission published the Mid Term Review (MTR) Action Plan for a Capital Markets Union. One and a half years after the publication of the original Action Plan, this MTR comes at a convenient moment to take stock of what has already been done and analyse future challenges arising from recent events such as the decision of the United Kingdom to leave the European Union (Brexit). This revised Action Plan has been issued after consulting with the industry on further developments that could help boost the project. The CMU is still one of the main priorities of the European Commission, as was highlighted in the recently released Reflection Paper on the Deepening of the Economic and Monetary Union. A well functioning CMU will increase private risk-sharing, the resilience of the financial sector and the shock-absorbing capacity of the economy.

The CMU remains a flagship priority of the Commission. The MTR Action Plan constitutes a further effort to give a final boost to the development of this project and towards to its planned completion in 2019. Since the publication of the Action Plan in September 2015, more than half of the 33 actions in the plan have already been delivered. Most notably significant work has been undertaken in cornerstone areas of the Action Plan:

- **Promoting alternative sources of funding for SMEs**, with the recent passing of a new regulation for European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF).
- **Revitalising securitisation markets in Europe**, with the recently reached agreement on a regulation for simple, transparent and standardised securitisations.
- **Promoting access to capital markets**, with the new regulation on prospectuses that will simplify the rules, administrative procedures and cost of issuance in capital markets.

This MTR Action Plan builds on actions already developed and analyses new challenges arising from a changed economic environment, mainly due to the Brexit. It identifies new priority actions to help finalise implementation of the CMU agenda.

Towards a Capital Markets Union 2.0

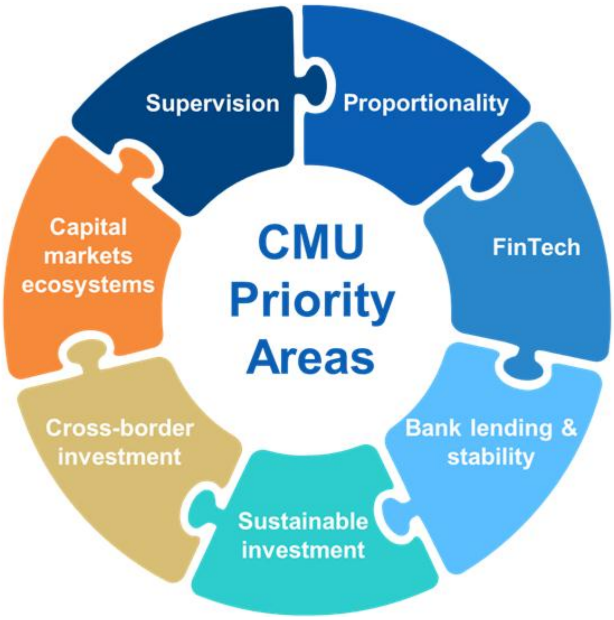
The decision of the United Kingdom to leave the European Union creates a new economic environment for capital markets in Europe. The United Kingdom has the largest capital market in the EU, providing key services to the rest of the EU, such as in risk management. Yet, far from detracting from the project, Brexit actually reinforces the idea that a genuine CMU is more necessary than ever.

Based on the responses to the recent consultation and taking into account the new challenges arising, the Mid Term Review re-examines the CMU agenda and sets out new priority actions for a Capital Markets Union 2.0.

New priority initiatives

The MTR includes a new set of priorities which will be included in the Commission's 2018 work programme and can be grouped into 7 major categories:

Figure 1 CMU priority areas



Source: BBVA Research based on the European Commission's Mid Term Review of the Capital Markets Union Action Plan

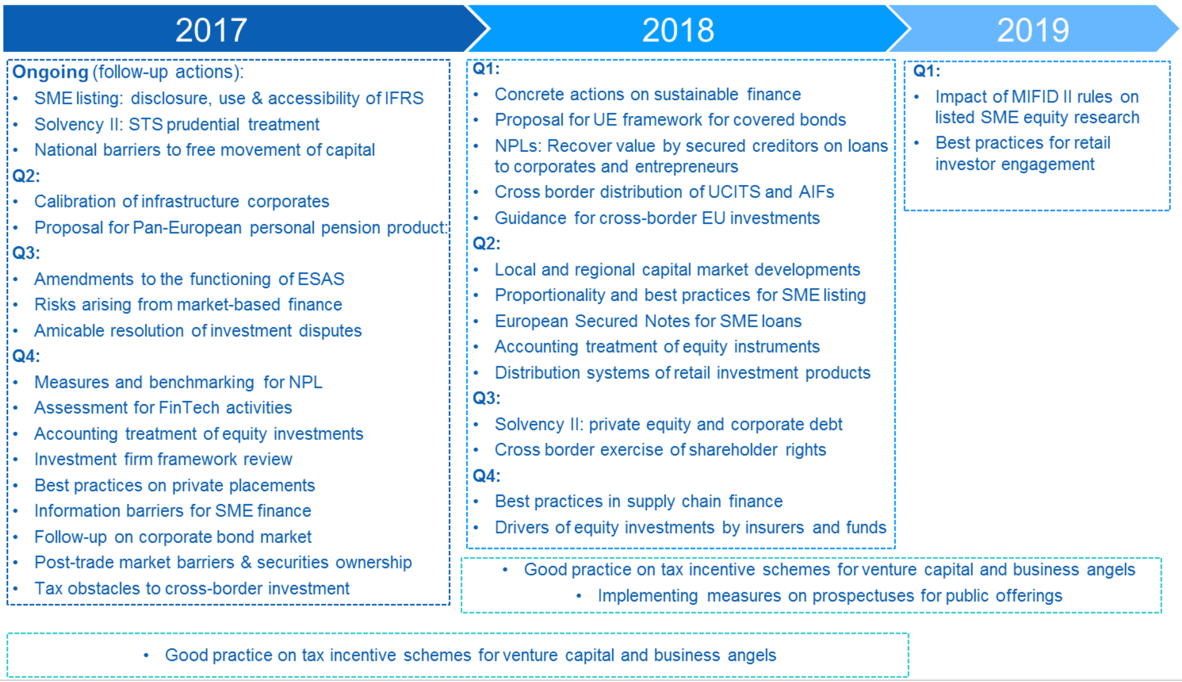
- **Strengthening the effectiveness of supervision to accelerate market integration**. To this end, the Commission will propose amendments to the functioning of the ESAs, and specifically of ESMA, in order to promote regulatory harmonisation and convergence with a view to removing barriers to cross-border investment. In this vein, the recent Reflection Paper on the Deepening of the Economic and Monetary Union already included the possibility to move towards a Single European Supervisor for markets and insurance.
- **Enhancing the proportionality of rules to support initial public offerings and investment firms**. To follow up on the work already done on SME access to public markets, the Commission will assess possible modifications to currently existing rules to achieve a more proportionate regulatory environment for SMEs. Moreover, the Commission will issue a legislative proposal for a revision of the current regulatory framework for investment firms to make it more proportional to their size and the nature of their activities.
- **Harnessing the potential of FinTech**. Based on the findings from the recent consultation on the impact of new technologies on financial services, the Commission will gauge the viability of developing an EU licensing and passporting framework for FinTech activities.

- **Using capital markets to strengthen bank lending and stability**. Non-performing loans are highlighted as a challenge for certain national banking systems. To help overcome this, the Commission will take several actions aimed at reinforcing secondary markets for these assets.
- **Strengthening the EU's leadership on sustainable investment**. The Commission will decide on concrete follow-up actions for the High-level Expert Group's recommendations. Specifically, efforts will be made to improve disclosure and to build sustainability into rating methodologies and supervisory processes. An interim report is expected to be released by July 10, with the final report to be published next December. This will contain a raft of recommendations for integrating sustainability into the EU's financial regulation.
- **Cross-border investment**. To promote the geographical distribution of funds among jurisdictions, the Commission will work on providing guidance about applying EU rules on how to treat cross-border investments and on amicable resolution of investment disputes. Moreover, the Commission will weigh up the options for a legislative proposal to facilitate cross-border distribution and supervision of funds.
- **Supporting the development of local capital market ecosystems**. Building on the Vienna initiative's Working Group, the Commission will propose a strategy at EU level to support local and regional market development in the EU, especially in Central, Eastern and South-Eastern Europe (CESEE).

Future lines of work

The revision of the Action Plan and agenda for the CMU is based on a concrete set of actions that need to be taken in the run-up to 2019. The Commission provides a very detailed plan to deliver specific actions (see Figure 2):

Figure 2 Future lines of work proposed by the Commission



Source: BBVA Research based on the European Commission's Mid Term Review of the Capital Markets Union Action Plan

Three legislative proposals that are central to the creation of CMU

Among all the envisaged measures, the Commission has announced to move quickly in three specific actions:

- **A legislative proposal on a Pan-European Personal Pension product (PEPP)** (June 2017). This product is conceived as a long-term retirement savings product to complement existing pension products and schemes.
- **Legislative proposal for conflicts of laws rules for third party effects of transactions in securities and claims** (Q4 2017). By removing the uncertainty about the applicable law, this legislative proposal will seek to promote cross-border investments.
- **Legislative proposal for an EU framework for covered bonds** (Q1 2018). Designed to achieve a more integrated market in the EU that maintains the quality of existing covered bonds.

BBVA Research assessment

- **This Mid-Term Review of the CMU Action Plan is well-timed to take stock of what has already been done, and to take into account and adapt the CMU agenda to new challenges.** This project needs a final boost towards its completion in 2019, especially after some of the more recent events, such as Brexit which, far from diminishing the significance of this project, increases the need to develop a genuine CMU for the European Union. Nevertheless, the envisaged timeline for specific actions seems ambitious and will require a substantial effort to put all the measures in place.
- **Supervisory convergence is key to the success of the CMU**. The need to harmonise supervisory and regulatory practices for capital markets is even greater with Brexit, all the more because the relocation that this event will give rise to is not likely to play out *en masse* or be towards only one Member State, but rather to several different jurisdictions. In this context, regulatory and supervisory convergence will play a key role in avoiding an uneven playing field and helping to address fragmentation issues while maintaining high regulatory and supervisory standards.
- **Banks will still play a major role in the CMU**. Promoting alternative funding sources for SMEs and facilitating their access to capital markets is a positive goal, but we must not forget that banks play (and will continue to play) a significant role, both as intermediaries in capital markets and as providers of funds for the real economy. Here it is important to have certainty about the regulatory framework and to avoid piling pressure on banks in the context of incipient economic recovery.
- **The focus on cross-border investment and private risk-sharing is also positive**. Nevertheless, involvement and commitment from Member States will be necessary to harmonise certain policies which persist on a national level and are still seen as a major barrier to cross-border investments, such as tax rules.

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