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Regulatory Newsflash

Steps towards the development of the
Capital Markets Union

On March 12, the European Commission (EC) took a major step towards the development of a [Capital Markets Union \(CMU\)](#). Concrete proposals have been published promoting alternative sources of financing and removing barriers to cross-border investments (see [press release](#)). The new proposals concretely aim to [boost the cross-border market for investment funds](#), [promote the EU market for covered bonds](#) as a source of long-term finance, and ensure [greater certainty for investors when dealing in cross-border transactions of securities and claims](#).

Facilitating cross-border distribution of investment funds

The proposals, a draft Regulation and Directive, amend the UCITS ([2009/65/EC](#)) and AIFM Directives ([2011/61/EC](#)). The proposals are expected to reduce the cost of cross-border distribution of funds and are intended to support a more integrated single market for investment funds, whilst maintaining high levels of investor protection. The proposals address issues such as regulatory barriers concerning marketing requirements, regulatory fees and administrative and notification requirements.

- The proposed [Regulation](#) – an overview of key changes:
 - The proposed regulation sets out requirements for marketing communications, including requiring AIFMs and UCITS management companies to ensure all marketing communications to investors are identifiable as such and present the risks and rewards of purchasing units or shares of an AIF or of a UCITS in an equally prominent manner.
 - A new transparency framework has been proposed for national provisions on marketing requirements. Competent authorities must publish online applicable national laws and administrative provisions governing marketing rules for AIFs and UCITS.
 - An ESMA central database has been proposed to streamline the information flows between national regulators and asset managers. ESMA will be responsible for maintaining a central database of national marketing requirements, as well as an information hub on all AIFMs, UCITS management companies, AIFs and UCITS.
 - National competent authorities should inform ESMA every year of any decisions they have taken in rejecting or requesting adaptations to marketing communications submitted by cross-border asset managers. ESMA has been given a mandate to develop draft implementing technical standards for standard forms and templates.
 - The Commission has proposed common principles concerning fees or charges levied by competent authorities. It also states that fees must be “proportionate to supervisory tasks carried out”.
- The proposed [Directive](#) – an overview of key changes:

- The Commission has set out proposals to amend the UCITS Directive. Whilst Article 92 of the UCITS Directive does not impose the obligation on the UCITS to have local facilities in each Member State where UCITS are marketed, in practice, many Member States require facilities on their territory for making payments to unit-holders, repurchasing or redeeming units and providing information to investors. A few Member States also require these local facilities to perform additional tasks, like handling complaints or serving as a local distributor or being the legal representative, including dealing with the national competent authority. The Commission argues that this is costly and has limited added value given the use of digital technology. Therefore, the draft Directive proposes to ban the imposition of physical presence. This means that while Member States need to ensure that the UCITS management company establishes, in each Member States where it intends to market units of UCITS, facilities to perform certain tasks (e.g. making subscriptions, payments or repurchasing or redeeming units), Member States “shall not require the UCITS management company to have a physical presence for the purposes” of undertaking those tasks. The proposal allows fund managers to use electronic or other means of distance communication with investors.
- The proposed directive amends AIFM Directive by adding a pre-marketing definition and laying down the conditions under which an EU AIFM can engage in pre-marketing activities. To provide sufficient safeguards, AIFMs are allowed to test an investment idea or investment strategy with professional investors but may not promote an established AIF without notification.
- The Commission states that the absence of clear and uniform conditions for the discontinuation of marketing of units or shares of a UCITS or an EU AIF in a host Member State creates economic and legal uncertainty for fund managers. It therefore sets out proposed conditions, including thresholds, under which deregistration could take place.

The Commission is inviting feedback on its proposals. The consultation will close on 9 May 2018. The proposal will also be discussed by the European Parliament and the Council.

European covered bonds

The Commission proposed common rules – consisting of a Directive and a Regulation – for covered bonds. The proposed rules are based on high-quality standards and best practices. They aim to enhance the use of covered bonds as a stable and cost-effective source of funding for credit institutions, especially where markets are less developed. They will also give investors a wider and safer range of investment opportunities. At the same time, the proposal seeks to reduce borrowing costs for the economy at large.

- The proposed [Directive](#):
 - Provides a common definition of covered bonds, which will represent a consistent reference for prudential regulation purposes;
 - Defines the structural features of the instrument (dual recourse, quality of the assets backing the covered bond, liquidity and transparency requirements, etc.);
 - Defines the tasks and responsibilities for the supervision of covered bonds; and
 - Sets out the rules allowing the use of the 'European Covered Bonds' label.
- The [Regulation](#) amends the Capital Requirements Regulation (CRR) with the aim of strengthening the conditions for granting preferential capital treatment by adding further requirements.

By making a cost-effective and long-term funding source available, these rules aim to help financial institutions - in particular banks - to finance the economy. The proposals also intend to increase cross-border flows of capital and investments. This will provide investors with a wider and safer range of investment opportunities, contribute to financial stability and help finance the real economy. The objective of the proposals is also to reduce borrowing costs for the economy at large.

The Commission is inviting feedback on its proposals. The consultation will close on 9 May 2018. The proposal will now also be discussed by the European Parliament and the Council. Once adopted, an implementation period of 12 months is envisaged before the new regime starts to apply.

Law applicable to third-party proprietary effects of the cross-border assignment of claims

The assignment of a claim refers to a situation where a creditor (assignor) transfers the right to claim a debt to another person in exchange of a payment. This system is used by companies to obtain liquidity and access credit. At the moment, there is no legal certainty as to which national law applies when determining who owns a claim after it has been assigned in a cross-border case. The new rules proposed today clarify according to which law such disputes are resolved. The current uncertainty as to the applicable law creates a higher legal risk in cross-border transactions compared to domestic transactions.

The proposed [Regulation](#) includes a general rule that in conflict situations the law of the country where the assignors have their habitual residence would apply. The *law of the assignor's habitual residence* is easy to determine and most likely to be the place in which the main insolvency proceedings with respect to the assignor will be opened. The proposal is also particularly suitable for bulk assignments and assignments of receivables under future contracts, which are an important source of finance for SMEs.

However, special rules are needed to cater for sectors which may not be well served by the rule of the law of the assignor. This is why *the law of the assigned claim* applies to two types of specific claims, which are therefore exempted from the general rule:

- Cash on the account of a credit institution (for example a bank, where the consumer is the creditor and the credit institution is the debtor);
- Claims derived from financial instruments, such as derivatives.

In addition, for securitisation transactions, the EC proposes a choice between the law of the assignor and the law of the assigned claim.

The Commission has also published a [communication](#) to clarify which country's law applies when determining who owns a security in a cross-border transaction. Enhanced legal certainty aims to promote cross-border investment, access to cheaper credit and market integration.

The EC will continue to closely monitor developments in this area. Within the next five years, it will assess how national interpretations and market practices have evolved in light of international and technological developments. Furthermore, the impact of specific issues on the functioning of the internal market will be assessed.

Progress of the CMU

Below you can find an overview of the progress made on the CMU, as included in the [EC's factsheet](#):

| PROGRESS ON CMU | | | | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------|---------------------|-------------------------------|
| MEASURE | DESCRIPTION | Decision-making process | | |
| | | European Commission | European Parliament | Council of the European Union |
| Rules for simple, transparent and standardised securitisation | New rules that will broaden investment opportunities and boost lending to Europe's households and businesses. Adopted by the co-legislators in 2017. | ● | ● | ● |
| New Prospectus Regulation | New rules that will facilitate access to financial markets for companies, particularly small and medium-sized enterprises. Adopted by the co-legislators in 2017. | ● | ● | ● |
| Review of European Venture Capital Fund Regulation (EuVECA) and European Social Entrepreneurship Funds Regulation (EuSEF) | New rules to stimulate venture capital and social investments in the EU. Adopted by the co-legislators in 2017. | ● | ● | ● |
| Solvency II adjustments | Rules to foster insurers' investments in infrastructure projects and corporate projects. Amendments on infrastructure investment entered into force in 2016. Amendments on infrastructure corporates entered into force in 2017. | ● | ● | ● |
| Legislative proposal on business insolvency | The Commission presented a legislative proposal on preventive restructuring and second chance in November 2016. The proposal is currently under negotiation in the Council. | ● | ● | ● |
| Capital requirement adjustments (CRR) | Rules to foster banks' infrastructure investment. Proposed by the Commission as part of the November 2016 banking package. | ● | ● | ● |
| Commission proposal for a Pan-European Personal Pension Product (PEPP) | New rules will provide pension providers with the tools to offer a simple and innovative pan-European personal pension product. Commission presented the proposal in June 2017. | ● | ● | ● |
| Commission proposal for a review of the European Supervisory Authorities | Reform of the EU's supervisory architecture for stronger and more integrated financial markets. Commission presented the proposal in September 2017. | ● | ● | ● |
| More proportionate and effective rules for investment firms | The Commission presented a legislative proposal for a more targeted regime to reduce risks in investment firms activities in December 2017. | ● | ● | ● |
| Commission Action Plan on sustainable finance | EU strategy to encourage green and sustainable investments with regulatory measures. Presented in March 2018. | ● | - | - |
| Commission Action plan on financial technology (FinTech) and a legislative proposal for an EU framework on crowdfunding and peer-to-peer lending | EU strategy to promote financial innovation while protecting consumers and investors. New EU rules to boost and facilitate cross-border activity in the crowdfunding sector. Presented in March 2018. | ● | ● | ● |
| European covered bonds | New rules to promote covered bond markets as a source of funding for banks thereby increasing lending to the economy. | ● | ● | ● |
| Facilitate cross-border distribution of investment funds | Legislative initiative for easier EU-wide distribution of investment funds. | ● | ● | ● |
| Clear rules on ownership of securities and claims | | | | |

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