

## REGULATORY DEVELOPMENTS IN EUROPE: 2017 OUTLOOK

DECEMBER 2016

“It is us listening that motivated my Commission to withdraw 100 proposals in our first two years of office, to present 80% fewer initiatives than over the past five years and to launch a thorough review of all existing legislation. Because only by focusing on where Europe can provide real added value and deliver results, we will be able to make Europe a better, more trusted place.”

— Jean Claude Juncker, President, European Commission,  
State of the Union address, Sept. 2016<sup>1</sup>

### Overview

In 2016, regulatory developments have been set against a backdrop of political uncertainty and change. In Europe, the UK's referendum decision to leave the European Union has fundamentally changed the dynamics of European policymaking, and may have a profound impact on the course of regulation in development. BlackRock continues to advocate for our clients and contribute to legislators' thinking on policies that bring about positive change for retail and institutional investors.

Key themes remain ensuring global financial stability, and stimulating growth by reducing barriers to the flow of cross-border capital in Europe. To this end, the first wave of legislative work related to the European Capital Markets Union (CMU) initiative is underway, as well as a review of the effectiveness and cumulative impact of the more than 40 pieces of financial services legislation passed in Europe since the financial crisis.

New policy measures increasingly reflect the themes of cost transparency, digitalisation, long-termism, and environmental, social and governance (ESG) factors. The combination of greater longevity and continued low interest rates have also increased the need to revitalise pensions systems. Proposals at national and European level seek to ensure EU citizens save adequately for retirement, and that those savings are put to productive use in the economy.

This *ViewPoint* serves as a summary of the key financial services policy developments impacting retail and institutional investors and distributors in Europe.

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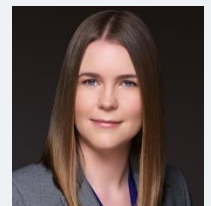
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## Preface

### The UK's withdrawal from the European Union

On 23rd June 2016, the UK voted by referendum to end its membership of the European Union.

According to the process for withdrawal set out under Article 50 of the Lisbon Treaty, once a Member State formally notifies the European Council of its intention to withdraw from the European Union, it must negotiate and conclude a withdrawal agreement with that Member State, which sets out the arrangements for its withdrawal and takes account of the framework for its future relationship with the European Union.

The EU Treaties will cease to apply to the UK from the date of entry into force of the withdrawal agreement or, if no new agreement is concluded, two years after the Article 50 notification, unless there is a unanimous decision of the remaining Member States to extend the negotiating period.

The process of the UK's withdrawal from the EU could have an impact on the course and application of regulation in development. The loss of UK voice in the Council and Parliament could alter legislative proposals not yet finalised, and some of these may ultimately not apply to the UK.

Given the many uncertainties at this stage on the type of deal that the UK and EU might agree, as well as the timing of the process, we focus in this paper on providing an overview of the regulatory pipeline as it stands.

## Financial stability

### The global financial stability agenda

IMPACT	Asset Managers
DEC 2015	IOSCO Final Report on Liquidity Management Tools in Collective Investment Schemes set out tools that managers can use across many global jurisdictions to counter market events.
AUG 2016	FSB published its third consultation on asset management: Consultation on Proposed Policy Recommendations to Address Structural vulnerabilities for Asset Management Activities.
END 2016	FSB recommendations to the G20 expected.
Mid-2017	Macro-prudential legislative review expected from the European Commission.
End-2017	IOSCO granular standards on liquidity expected.
End-2018	IOSCO simple measures of leverage expected.

#### IMPACT ON INVESTORS, AND BLACKROCK VIEW

Global financial stability remained an important theme on the policy agenda in 2016. In August, the Financial Stability Board (FSB) published their third consultation on asset management, this time focusing on measures to address perceived vulnerabilities relating to specific activities. Of the FSB's 14 recommendations, 9 centred on liquidity, with the others relating to leverage, operational risk and transferring investment mandates and securities lending. BlackRock commends the FSB for pursuing a first principles approach to asset management products and activities. We largely agree with the majority of recommendations addressing liquidity and leverage, the implementation of which will improve protections for investors and, in turn, strengthen the financial system. We also see value in regulators collecting additional data on asset management products and activities.

In our view, system wide stress tests as proposed by the FSB would provide misleading results in the absence of sufficient data available. The consultation notes that, "third-party asset managers as a group only manage about one-third of the total financial assets of pension funds, sovereign wealth funds, insurance companies and high net worth individuals." By failing to account for the two-thirds of the world's assets that are not managed by asset managers, such a stress test would at best be meaningless and at worst, could drive misguided policy responses. A stress test based on aggregate assumptions across a very diverse universe of funds would not be conclusive, while a top down stress test of managers would not reflect the fact that it is asset owners, not asset managers, who control strategic allocation decisions, and further, that fund assets and liabilities are not on the balance sheet of the asset manager. To better achieve

the FSB's objectives, we recommend developing global, granular guidelines for stress testing the ability of individual funds to meet redemptions. In addition, global harmonisation of the form and scope of data reported would be of great benefit to both the industry and regulators. We encourage global standard setters, such as International Organisation of Securities Commissions (IOSCO), to prioritise this, as well as the removal of barriers to data sharing.

The consultation also addresses operational risk. We note that this is not the same as systemic risk, and that mitigating operational risk is important to *all* asset managers. Limiting the scope to third party service providers affiliated with asset managers ignores the presence of numerous vendors and institutions that play critical roles in the provision of services to the asset management industry. To understand the implications for financial stability, it is necessary to review all vendors, not just those affiliated with asset managers.

A new dialogue has also begun on the concept of extending macro-prudential rules beyond banking. This raises many questions, including on the scope of entities, activities, policy measures or tools it may involve, and which regulator would assume authority. We expect a robust discussion in 2017.

We recommend that the FSB first conduct an analysis to better understand the role of third party vendors in asset management, as outlined in our *ViewPoint: [The Role of Third Party Vendors in Asset Management](#)*, before determining whether a policy response is needed. For details, see our [response to the FSB's Consultative Document on Proposed Policy Recommendations](#).

### EMIR & CCP Resilience, Recovery, Resolution

IMPACT	Investors using derivatives, whether for hedging or taking a market view
MAY 2015	EMIR Review launched.
AUG 2016	CPMI-IOSCO consultative report on CCP Resilience and Recovery published.
	FSB discussion note on CCP Resolution Planning published.
NOV 2016	European Commission CCP Recovery and Resolution legislative proposal published.
Now - 2019	Clearing obligation start dates differ by product.

#### IMPACT ON INVESTORS, AND BLACKROCK VIEW

The practice of clearing derivative trades through a central infrastructure removes much of the counterparty risk inherent in bilateral transactions – the rationale underpinning the European Market Infrastructure Regulation (EMIR). It also

brings the benefits of greater transparency for regulators and helps strengthen oversight of derivatives markets. At the same time, central clearing concentrates risk in a handful of Central Clearing Counterparties (CCPs). End-investors are required to use CCPs, and often there is little choice of CCP for a given product. The resilience of CCPs is therefore of great importance, as is limiting the extent to which end-investor monies are exposed in the event that a CCP in difficulty needs to be recovered or resolved. We recommend a focus on the three Rs: Resilience, Recovery and Resolution.

**Resilience:** In our view, policy makers should seek to reinforce CCP resilience through incentives, such as requiring CCP owners to retain a risk-based 'skin in the game' (capital) stake in protecting deposited client assets.

**Recovery:** End-investors using CCPs, such as pension funds and insurance companies, deposit money in good faith. Undermining that trust by hair cutting Initial Margin (IM) and / or Variation Margin (VM) in recovering or resolving a CCP in difficulty will erode investor confidence in clearing, and could have pro-cyclical systemic effects. IM haircutting should not be an option, and VM haircutting considered only as a recovery tool of last resort, subject to strict conditions for eventually recovering the haircut funds to users.

**Resolution:** Maintaining a CCP at all costs is not always in the best interests of the financial system. If a CCP has exhausted its default waterfall it should be required to implement a resolution plan quickly, focusing on a rapid and complete wind down of positions, along with a timely and orderly return of margin. An uncapped liability by market users towards a failing CCP will undermine investor confidence in clearing and lead to suboptimal investment and could ultimately become an additional source of volatility.

### Key features of EMIR and the CCP R&R proposal

- ▶ In its 2015 review of EMIR, the Commission assessed a number of specific aspects of the Regulation, including:
  - the access of CCPs to central bank liquidity facilities
  - reporting requirements under EMIR
  - the functioning of supervisory colleges for CCPs
  - the margin practices of CCPs
- ▶ The EU CCP Recovery and Resolution proposal closely aligns with global principles on the issue developed by the Committee on Payments and Market Infrastructure (CPMI), the IOSCO and the FSB:
  - Maximum flexibility on toolbox – aiming not to mandate or exclude any options proposed by CPMI-IOSCO / FSB, other than IM haircutting, on which the proposal is silent.
  - A degree of alignment with the Bank Recovery and Resolution Directive (BRRD) – except for the point of non-viability (PoNV) and intervention by authorities, which is likely to be more subjective.

## Money Market Fund Regulation (MMFR): Stable NAV funds under scrutiny

IMPACT	All European domiciled money market funds – both prime and government funds
SEPT 2013	European Commission proposal for a MMF Regulation published.
APR 2015	European Parliament position agreed.
JUN 2016	The Council position agreed.
NOV 2016	Provisional agreement between Parliament and Council announced.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

In recent years, the Money Market Fund (MMF) industry has seen considerable changes globally as a result of challenging market conditions and ongoing reform discussions. While the US has implemented its own rules, European discussions have been slower-moving. Although the proposal for the Regulation was originally adopted by the Commission in September 2013, the Parliament was unable to agree its negotiating position until April 2015. The Council, after a long deadlock, was only able to agree its position in June 2016. Technical work is still ongoing, but negotiations between the Parliament and Council are expected to conclude before the end of the year.

MMF reform in Europe – especially the question of the future of stable/Constant Net Asset Value (CNAV) funds – has proved particularly divisive. Some Member States (led by France and Germany) would prefer to see the industry transition to a floating/Variable NAV (VNAV). Others prefer to retain the CNAV model to the greatest extent possible – subject to stricter regulatory constraints.

The final Regulation will allow a CNAV fund only for government debt, and will introduce a new 'Low-Volatility NAV' (LVNAV) fund, intended to capture the current prime CNAV market. The LVNAV would retain certain CNAV-like features (such as pricing to 2 decimal places, and dealing on a constant share price) during normal market conditions, but would be required to function as a VNAV during times of market stress (where the mark-to market NAV has deviated from the stable NAV in excess of a prescribed tolerance level). Both products would have the possibility that redemption gates or fees could be imposed in certain circumstances – similar to prime funds in the US. This would leave investors with a range of MMFs to meet their needs.

We believe that these fund structures represent a workable compromise, and continue to engage with policymakers to ensure that the final details of the Regulation ensure that the funds retain the features that investors value most: intraday settlement and operational ease of use.

## IMPROVING FINANCIAL MARKET TRANSPARENCY: THE VALUE OF REPORTING CONSISTENT DATA

The optimal conditions for investment are created by regulatory regimes that protect investors and facilitate responsible growth of capital markets. Financial market transparency, delivered through appropriately detailed and timely reporting, underpins well-regulated and robust markets where risks are monitored and properly understood.

At the time of the 2008 global financial crisis, financial markets were lacking the regulatory framework that exists today. Enhanced reporting to regulators and information disclosure to investors became cornerstones of the regulatory response enshrined in the 2009 G20 Pittsburgh Declaration<sup>2</sup>.

Today, regulators continue to introduce reporting regimes in line with the Pittsburgh Declaration. These initiatives are generally laudable, however, differing data reporting requirements present a significant challenge in comparing information globally.

In its review of the cumulative impact of post-2008 regulation (see [page 6](#)), the European Commission acknowledged concerns raised by industry participants regarding the usefulness of multiple and duplicative data requests:

“The volume of data collected and exchanged between national authorities and the European supervisory authorities has drastically increased. That's clear. Less clear is whether it's all essential. So we're taking forward a project on data standardisation to improve reporting with new technology. This should also give us a better idea of where the burden is unnecessary, so we can reduce it.”<sup>3</sup>

In our view, a better balance between stimulating economic growth and monitoring risk could be found through a system-wide review of global reporting requirements.

Over the short term, we encourage policy makers to focus on:

1. **Clarity of purpose.** Consider how data will be used, and how it can be leveraged to provide feedback to the market.
2. **Standardisation of data requests.** This ranges from reaching globally agreed measurement and definitions of key terms, through to a common approach on the detail, format and frequency of requests.
3. **Standardisation on how information is reported.** Electronic data delivery whenever possible should be the objective. This would substantially improve the accuracy and quality of data as well as the timeliness of reporting.

At the global level we recommend that IOSCO expands on its study of data gaps in asset management, announced in June<sup>4</sup>, by assessing how similar data requests vary across jurisdictions and establishing a working group tasked with agreeing a common transaction reporting template for relevant capital market products and activities.

Over the medium term, we encourage the migration to uniform reporting platforms. The EU and US each have multiple reporting platforms. A significant step would be for each to commit to a single internal reporting platform enabling regulators to share information more efficiently.

Over the longer term, we recommend that efforts are made to develop a single global data repository, subject to robust reassurances regarding cyber security and the protection of data. Short of that, reporting identical data to multiple databases would mark a significant improvement over the status quo.

For more detailed analysis and perspectives on how regulators and investors would benefit from more harmonised data, please see our *ViewPoint* [Improving Transparency: The Value of Consistent Data over Fragmented Data](#).

# Capital Markets Union

## Facilitating market finance across Europe

The Capital Markets Union (CMU) remains a key political priority for the European Commission. Not a single piece of legislation itself, but a conceptual framework housing a series of policy initiatives, the CMU aims to remove barriers to the free flow of cross-border capital in the EU, and increase the role that market-based finance plays in channeling capital to European companies.

A year after the launch of the CMU Action Plan in September 2015, President Juncker used his State of the EU speech to highlight the delivery of CMU as more important than ever, showing clear political momentum, and determination not to be delayed by the UK's decision to leave the EU. In a new roadmap published in September 2016, the Commission reflected on progress to date on the first wave of initiatives, and accelerates further efforts to deliver the CMU. A mid-term review is expected in 2017, with the bulk of the initiatives due to have been delivered by 2019.

The first wave of legislative work focused on delivering an updated regime for securitisation ([page 7](#)); replacing the Prospectus Directive with a Regulation ([page 8](#)); and increasing the appeal of the EuVECA venture capital and EuSEF social enterprise vehicles ([page 9](#)) by end of 2016.

Activity to tackle barriers to cross border investments includes harmonising insolvency regimes ([page 10](#)), addressing tax barriers ([page 25](#)), and a refreshed European Fund for Strategic Investments (EFSI) ([page 11](#)).

Further priorities will include reviewing the cross-border framework for pensions ([page 23](#)), streamlining access to retail investment products ([page 12](#)), green finance ([page 13](#)), and harnessing technology for capital markets.

We welcome the Commission's focus on increasing the role that market finance plays in the European economy, in diversifying the sources, and potentially drive down the cost of funding to the benefit of European companies and investment projects. The success of the CMU will ultimately depend on the ability of each legislative initiative to reflect the interests of the savers and investors that represent the 'Capital' in the Capital Market Union.

## Call for Evidence: Cumulative Impact of EU Regulation for Financial Services

IMPACT	Investors and listed companies
SEPT 2015	European Commission Call for Evidence on the cumulative impact of financial regulation.
FEB 2016	'Call for evidence' consultation period closed.
MAY 2016	European Commission public hearing.
NOV 2016	Conclusions from Call for Evidence published.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

The global regulatory response to the financial crisis has resulted in the most far reaching reforms to global financial markets in decades. In Europe alone, more than 40 pieces of legislation have been passed, many aimed at restoring confidence and building a more resilient financial system. While we believe that the financial system is indeed more robust, a tendency exists for regulation to address specific issues in isolation, and we are only beginning to understand the full effects of how these fragmented and siloed measures interact, and how different investor types will be impacted.

In 2015, the Commission committed itself to reviewing the effectiveness, overlaps, and cumulative impact of these measures, launching a public call for evidence. The consultation sought input on four thematic areas: rules affecting the ability of the economy to finance itself and to grow; unnecessary regulatory burdens; interactions, inconsistencies and gaps; and rules giving rise to possible unintended consequences. Following a review of the responses received, the Commission published their own conclusions in November 2016.

We welcome the Commission's initiative to reflect on work to date, and address issues around reducing combined regulatory burdens. In taking forward the conclusions, we see ample opportunities for the Commission to make calibrations to the policy framework where necessary to ensure that markets function to the optimum benefit for their end-users: the companies and projects that raise financing from markets, and the end-investors who commit their capital.

For more details, see our detailed [response to the European Commission's Call for Evidence](#).

### BEPS: UNINTENDED CONSEQUENCES OF TAX MEASURES ON INVESTMENT IN REAL ASSETS

The original objective of the OECD's Base Erosion and Profit Shifting (BEPS) project was twofold - to eliminate double non-taxation by multi-national corporates, while avoiding the creation of new rules that "result in double taxation, unwarranted compliance burden or restrictions to legitimate cross-border activity"<sup>5</sup>. We support the policy intent behind the initiative, however, the second goal has not been met. Unintended consequences are likely to have a significant impact on funds investing cross-border in private assets, including infrastructure, green technologies, unlisted companies – some of the very investments the CMU seeks to promote. Impacted policy initiatives include Securitisation, Solvency II, ELTIF, private credit funds and EFSI, among others. For further details on BEPS, see [page 25](#).

## Simple, Transparent, Standardised Securitisation

IMPACT	Securitisation issuers, sponsors, and investors (e.g. pension funds, insurance companies, banks and investment funds)
	Original risk retention rules agreed in Capital Requirements Directive II (CRD II) (2009), and subsequently extended to other investors under AIFMD (2011) and Solvency II (2009).
SEP 2015	European Commission proposal for an STS Securitisation Regulation published.
Dec 2015	Council formally agrees a negotiating position.
Dec 2016	Parliament expected to agree negotiating position.
Jan 2017	Negotiations with the Council and Commission likely to begin.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

One of the EU's first regulatory actions following the financial crisis was to implement risk retention requirements for originators, sponsors or original lenders of a securitisation, in a bid to ensure greater alignment of interests between originators and investors. However, the legislative framework placed the responsibility to verify this retention with the investor, creating uncertainty, higher cost and increased compliance burden for those investors who are covered by it to date (credit institutions, alternative funds, and insurers).

As a key tenet of the CMU Action Plan, the European Commission published a legislative proposal in 2015, aimed at creating a more coherent framework for investment in securitisations. Simple, Transparent and Standardised (STS) securitisations – those that meet a range of criteria intended to minimise 'structural' risks – will benefit from a more favourable risk weighting under various prudential frameworks (e.g. CRR II, Solvency II).

The Council agreed its negotiating position by the end of 2015 – however, the Parliament has not yet finalised its position. In summer 2016, a wide range of amendments to the initial proposal were submitted by Members of the European Parliament (MEPs), centering on the key political issues of what the required percentage of risk retention should be, whether compliance with risk retention criteria should be certified by a third party, ensuring that the legislation is appropriate also for short-term securitisations, or Asset Backed Commercial Paper (ABCP), and the calibration of capital charges for investment in STS Securitisation.

We support initiatives to put the European securitisation market on a stronger footing. In our view, appropriately calibrated rules can help encourage the growth of the market. In particular, we welcome the attention on finding an

appropriately tailored STS framework for ABCP, as a failure to account for the structural differences between ABCP and ABS could unduly restrict existing programmes. This could constrain an important source of funding to many companies (including unlisted and unrated firms, as well as SMEs) and an important asset class for many investors due to its liquidity and high credit quality.

Negotiations in the Parliament have been slowed by disagreement over risk retention and other contentious issues, but if the Parliament is able to finalise a position by the end of 2016, final negotiations between the Council, Parliament and Commission would likely begin early in 2017.

### Key features of the Commission proposal on STS Securitisation

- ▶ Direct obligation on securitisation originators, sponsors and original lenders to retain a percentage of the net economic interest. The exact percentage is subject to much debate
- ▶ Extension of investor due diligence requirements to all types of institutional investors (currently they only apply to credit institutions, alternative investment fund managers, insurers)
- ▶ Qualitative criteria set out to define 'STS' term ABS
- ▶ Issuers self-certify compliance with the STS criteria, with strict liability provisions attached
- ▶ Separate legislative proposal to amend the CRD II framework looks at both the capital calibrations and the Liquidity Coverage Requirement (LCR)
- ▶ Measures to update Solvency II risk weights for STS securitisations expected in 2016 – it is unclear how the STS designation will fit with the existing Type 1 / Type 2 rules in the current Solvency II framework

For further detailed analysis, see our [detailed response to the Commission proposal on STS Securitisation](#).

## Solvency II: Prudential regime for insurers

IMPACT	European non-life insurance, life insurance, and reinsurance companies
JAN 2016	Solvency II entered into force.
APR 2016	Risk weights for infrastructure recalibrated.
2017	Further work on recalibration for investment in infrastructure corporates expected.
	Revision of risk weights to incorporate STS Securitisation framework expected.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

Solvency II, which came into force in January 2016, introduces a prudential regime for insurance and reinsurance undertakings in the EU. It sets the valuation basis for

liabilities and determines the amount of capital that insurers and reinsurers will have to hold against various market and non-market risks.

From an asset management perspective, developing an efficient investment strategy under Solvency II is an important consideration for many insurers. The proposed capital requirements for many traditional asset classes have now been stable for some time, but certain asset classes have been subject to further calibration – particularly infrastructure and securitisation, which are central to the CMU.

The European Commission sees infrastructure investment as an important asset class for driving growth in Europe, and requested that the European Insurance and Occupational Pensions Authority (EIOPA) revisit the regulatory treatment for both infrastructure projects and infrastructure corporates (e.g. network operators). EIOPA published a framework that defines ‘Qualifying’ Infrastructure Investments, which would attract a lower capital requirement. While lower capital requirements help overall capital efficiency, setting detailed qualifying criteria may help insurers new to this space to better understand the nature of this risks inherent in these investments. Also, subject to additional criteria certain debt investments may not need a formal credit rating. This would increase the range of potentially eligible investments.

Securitisation capital requirements have also attracted attention. The Commission has adopted proposals for the STS Securitisation framework, set to simplify the European securitisation market, and are currently being considered by the Council and Parliament. Once the STS framework is in place, the Commission expects recalibrated Solvency II capital requirements for securitisation to follow (see [page 7](#)).

### Key features of Solvency II

- ▶ An insurance company may conduct its activities throughout the EU after having obtained an authorisation from the supervisor of one Member State.
- ▶ Insurance companies must hold capital in relation to their risk profiles, to guarantee that they have sufficient financial resources to withstand financial difficulties.
- ▶ They must comply with capital requirements:
  - The minimum capital requirement is the minimum level of capital below which policyholders would be exposed to a high level of risk.
  - The solvency capital requirement is the capital that an insurance company needs in cases where significant losses must be absorbed.
- ▶ Insurance companies must put in place an adequate and transparent governance system with a clear allocation of responsibilities. They must have the administrative capacity to cope with a variety of potential issues, including risk management, regulatory compliance, and internal audit.

- ▶ Insurance companies must conduct their Own Risk and Solvency Assessment (ORSA) on a regular basis. This involves assessing their solvency needs in relation to their risk profiles, as well as their compliance with the financial resources required.

### Prospectus Regulation: Gateway to the market

IMPACT	Listed companies, providers of listed investments, and asset managers, pension funds, insurance companies and other investors who use the prospectus
NOV 2015	Review of the Prospectus Directive announced by the European Commission.
JUN 2016	The European Council reached its negotiating position on the proposed Prospectus Regulation (intended to replace the Directive).
SEPT 2016	The Parliament reached agreement on its position on the draft Prospectus Regulation.
OCT 2016	Start of negotiations between the Parliament, Council and Commission.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

The European Commission’s review of the Prospectus Directive was the second initiative under the banner of the Capital Markets Union. Through information disclosure requirements for listed companies, the prospectus regime serves both investor protection and market efficiency, and facilitates the flow of capital to companies. The review seeks to ensure that the cost and level of detail of disclosure are appropriately balanced, and that the Prospectus remains an efficient gateway to the market. In the interests of greater harmonisation across Europe, the Prospectus Directive will be replaced with a Regulation. The legislative proposal for the Prospectus Regulation is currently progressing through negotiations between the Parliament, Council and Commission. The draft Regulation states that the regulation will apply from a date 12 months after it enters into force. Therefore we expect that, at the earliest, this would be late 2017.

We are encouraged by the incorporation of measures that seek to manage prospectus length, improve comprehensibility of the information disclosed and the efficiency of the regime. Lengthy prospectuses lock-up capital in legal fees and other related costs – capital that could be more productively deployed elsewhere. This frictional cost can increase the hurdle rate of return of a project or company initiatives.



The re-introduction of some limited flexibility on the format and content of the prospectus summary should increase comprehensibility for the user, which conversely was impeded by overly proscriptive requirements. In particular, this should aid retail investors in their understanding of the risk profile of an investment opportunity.

### Key features of the Commission proposal on Prospectus Regulation

- ▶ Shorter prospectuses: To provide better and more succinct information for investors, there will be a new user-friendly summary consisting of three sections (key information on the issuer, the security and the offer/admission).
- ▶ A simplified prospectus regime for secondary issuances will widen the range of situations where a lighter prospectus may be prepared and reduce the costs on issuers.
- ▶ Ensuring availability of prospectuses and other disclosure documents via electronic means will be sufficient, removing the requirement to make hard copies available on demand.
- ▶ Monetary thresholds for exemption from the requirement to issue a prospectus are still to be agreed.

### Venture capital and social enterprise

IMPACT	Listed and unlisted SMEs, small mid-caps, social enterprises and large AIFMD-authorized asset managers
2013	The EuVECA and EuSEF fund regimes entered into force.
2015	2017 review brought forward to 2015, now included under the banner of the Capital Markets Union Action Plan.
JUL 2016	European Commission proposal on amending the EuVECA and EuSEF regulations published.
DEC 2016	European Council expected to finalise its negotiating position.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

Launched in 2013, the European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) were two new types of investment funds designed to make it easier and more attractive for institutions and high net worth individuals to invest in unlisted Small and Medium-sized Enterprises (SMEs). Both fund regimes have now been brought under the conceptual banner of the CMU, and the European Commission has brought forward a review, originally planned for 2017, starting with a consultation last year on measures to boost the attractiveness of these fund types.

In July 2016, the Commission published a proposal to improve the legislation, by:

- ▶ Expanding the list of eligible assets, to include small mid-caps, and SMEs listed on SME growth markets.
- ▶ Decreasing the costs and simplifying the registration and cross-border marketing of these funds.
- ▶ Extending the range of managers eligible to market and manage EuVECA and EuSEF funds to include larger fund managers, i.e. those with over €500 million AUM, who can provide economies of scale.

As a further initiative to stimulate venture capital investment in high-growth companies, the Commission is planning a pan-European venture capital fund of funds, seeking to channel greater volumes of private capital from institutional investors, and seeking to overcome the challenge of market fragmentation of the asset class. As a first step, the Commission together with the European Investment Fund (EIF) has published a call for interest from asset managers regarding managing the fund of funds. The initiative seeks to raise the size of European venture capital funds and address the current fragmentation, by obliging the future venture capital fund or funds to have operations in at least five Member States. Care should be given to ensure that unintended consequences of the Base Erosion Profit Shifting (BEPS) framework (see [page 25](#)) do not represent a barrier to investment in such funds.

The Commission is also reviewing how national tax incentives for venture capital and business angels can foster investment in SMEs and start-ups, with the aim of promoting best practice across Member States.

### Key features of the Commission proposal on EuVECA and EuSEF

- ▶ The EuVECA Regulation introduced a regime for funds supporting young and innovative companies.
- ▶ The EuSEF Regulation introduced a regime similar to the EuVECA label, but restricted to funds investing in enterprises that have a positive social impact as their primary objective.
- ▶ Both fund types come with a marketing passport, enabling managers to market them across the EU.
- ▶ Originally management of EuVECA and EuSEF funds was limited to smaller fund managers, with AUM of less than EUR 500 million.
- ▶ So far, around 70 EuVECA and 4 EuSEF funds have been launched.

## Private credit: Matching lenders with borrowers

IMPACT	Institutional investors with long investment horizons, unlisted companies and listed SMEs
2014	Central Bank of Ireland (CBI) authorised Qualifying Investor Alternative Investment Funds (QIAIFs) to grant loans, adding to their existing ability to invest in syndicated loans.
2015	Launched in 2015, European Long Term Investment Fund (ELTIF) (see <a href="#">page 11</a> ), may lend directly to unlisted companies or listed SMEs, infrastructure, and other real assets.
2015	At the end of 2015, French regulator AMF announced that specialised professional funds, securitisation vehicles, and professional private equity investment funds would be permitted to grant direct loans.
2016	Since 2016, European AIFs are permitted to lend directly to private companies in Italy, adding to existing vehicles including mini bonds, securitisation Special Purpose Vehicles (SPVs) and Italian AIFs.
2016	The German Federal Financial Supervisory Authority (BaFin) ruled private credit a permissible investment for closed-ended AIFs.
2016	The European Securities and Markets Authority (ESMA) published an opinion on elements necessary for a common European framework for loan origination by funds.
2017	European Commission consultation on private credit funds expected.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

At its simplest, the economic function of lending serves to increase the availability of capital, enabling businesses to invest, innovate and grow, public infrastructure to be developed, and jobs to be created.

The granting of loans has traditionally been limited in many jurisdictions to entities with a banking license. However, with bank finance constrained, businesses in some sectors have found it increasingly difficult to borrow. While we expect bank lending to remain the primary funding source in Europe, enabling pooled investment funds to also invest in private loans and bonds to medium sized companies or projects has the potential to improve the financing of the economy by facilitating the allocation of capital to non-listed asset classes. Institutional investors with long investment horizons are likely to be attracted to the asset class by the opportunity for long-term liability matching and income generation. In managing private credit funds, the asset manager would continue to act as an agent on behalf of its clients, and investment results,

whether positive or negative, are limited to the funds, which are separate legal entities. The fiduciary asset management business model therefore remains unchanged.

National level initiatives have been developed in several Member States in the past few years, and in April 2016 ESMA published an opinion, directed at the Commission, Council and Parliament. The Commission is reflecting on next steps and is expected to publish a consultation in 2017.

In our view, for private credit to fulfil its potential in Europe, a consistent framework is needed, to harmonise best practice from national regimes and overcome barriers to cross-border investment. Additional steps, such as improving insolvency regimes and providing access for approved non-bank investors in private credit to existing databases of credit information, such as the Banque de France's information repository (FIBEN), and potentially the ECB's new AnaCredit system, could have a considerable impact on willingness to invest in this asset class.

### Key features of private credit

- ▶ Diversity of financing sources contributes to economic stability by enabling businesses to seek alternative sources of funding during periods of constrained bank finance.
- ▶ Investment funds authorised to grant loans can match investor capital, with entities seeking to borrow.
- ▶ National level frameworks that enable investment funds to grant or participate in loans exist in some Member States already. In most cases, the rules enable AIFs to grant or participate in loans to private, non-financial companies, creating or extending local banking license exemptions.
- ▶ In Europe, managers of funds permitted to invest in private credit are comprehensively regulated under AIFMD, and subject to extensive reporting, risk management and compliance requirements. National rules may also apply.

### Insolvency and structural barriers to cross border investment in private assets

IMPACT	Asset managers, private assets, unlisted SMEs
NOV 2016	European Commission proposal on insolvency and restructuring proceedings published.
Q1 2017	Start of negotiations in European Parliament and among Member States.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

As part of the investment process, investors must consider what might happen to their investment were the business it is invested in to fail. Predictability of outcomes under varying national insolvency laws is therefore critical, to enable proper

assessment of likely risk and reward – all the more so for cross-border or longer term investments. With uncertainty acting as a barrier, companies in countries with less predictable legal outcomes face a lower flow and higher cost of capital.

The Commission recognised the critical role of insolvency laws in the CMU plan, including seeking convergence of the patchwork of EU rules as a key objective. In November, it published a legislative proposal for a common EU insolvency and restructuring framework.

The focus of the proposal is on restructuring of businesses in difficulty where insolvency can be avoided, and a clear commitment to ensuring a second chance for ‘honest entrepreneurs’ facing insolvency. Flexibility is left to Member States to decide whether to divide claims into secured and unsecured categories, reflecting the sensitivity around increasing harmonisation for some states.

We welcome the Commission’s attention on increasing speed and certainty in insolvency processes, and reducing barriers to the flow of capital. Beyond insolvency, however, there are structural barriers to cross border investment resulting from differing national withholding tax rules and procedures, and the potential unintended consequences of the Base Erosion Profit Shifting (BEPS) framework (see [page 25](#)) are still to be addressed. Tax uncertainty represents a risk, and a barrier to investment; and the uncertainty created by BEPS could have a significant impact on funds investing in private assets, including infrastructure, real estate, green technologies, unlisted companies – some of the very investments the CMU seeks to promote.

### Key features of the Commission proposal on insolvency and restructuring proceedings

- ▶ Simpler restructuring processes that do not require formal insolvency proceedings to be triggered.
- ▶ New finance agreed upon in the restructuring plan to be protected.
- ▶ A specific debt discharge period of three years is proposed, reflecting the importance of swift resolution.
- ▶ Specialised courts to rule on insolvency proceedings.
- ▶ A temporary stay of enforcement proceedings of up to four months can be requested, to support negotiations.
- ▶ Scope excludes insurance undertakings, credit institutions, investment firms and collective investment undertakings, CCPs, CSDs and other financial institutions subject to separate resolution frameworks.

## Long Term Investing: ELTIF and EFSI

IMPACT	Retail and institutional investors, pension funds, insurance companies and asset managers
2013	ELTIF proposed in 2013, and fully implemented in December 2015.
2014	Investment Plan for Europe launched by Jean-Claude Juncker.
JUN 2015	EFSI active since June 2015 – initially three year period of 2015 – 2018, now proposed to be extended to 2020.
JUN 2016	ESMA’s final report on Regulatory Technical Standards (RTS) for ELTIF published.
SEP 2016	Commission proposal for EFSI renewal published.
DEC 2016	Council agreement on general approach on EFSI expected.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

Sustainable growth, job creation and enhanced competitiveness remain high priorities for the Commission, and long-term financing will be central to delivering this. Commission initiatives aimed at connecting investment to the economy include the European Long Term Investment Fund (ELTIF) and the European Fund for Strategic Investment (EFSI).

The ELTIF – a type of closed-ended Alternative Investment Fund (AIF) – may invest in infrastructure projects, unlisted companies, listed SMEs, debt issuances and real assets, and comes with a marketing passport to both professional and retail clients enabling it to attract investment throughout the EU. The first ELTIFs launched in 2016 – potentially attractive to retail investors, high net worth individuals and smaller institutional investors who do not have specialised teams covering the underlying investments. In our view, critical to the success of funds seeking to invest cross border will however be resolving tax inefficiencies resulting from a diverse investor base and as unintended consequences of BEPS (see [page 25](#)). In June ESMA published a final report on ELTIF, and postponed delivery of Regulatory Technical Standards (RTS) on cost disclosure, to take into account work being undertaken on PRIIPs. The Commission will review the ELTIF regime by June 2019. As with most new fund structures, it will take some years for managers and investors to become familiar with the structure and decide whether it is a success.

Meanwhile the EFSI, managed by the European Investment Bank (EIB), aims to mobilise €315 billion of investment to fund EU infrastructure and SMEs, by providing a first loss guarantee using €21 billion of Commission and EIB capital. EFSI is already active in 26 Member States, with SMEs in

particular benefitting. In 2016 the Commission announced an extension beyond the initial three year period, aiming to increase the funding to at least €500 billion by 2020, with the focus on cross-border and sustainable projects. We welcome the EFSI's success in channeling investment, particularly to SMEs, however it is critical that it does not crowd out private sector investment for otherwise viable projects with attractive investment premiums. The principle of additionality is essential so as not to distort the market but also to ensure that the benefits of EFSI are spread around the EU. We support the Commission's proposal to detail why each project was chosen, and the criteria it meets.

**Key features of ELTIF and EFSI**

- ▶ The ELTIF is a closed-ended investment fund vehicle (with limited ability to offer redemptions) that can invest in infrastructure projects, unlisted companies or listed SMEs, and real assets.
- ▶ Managed by the EIB, EFSI aims to channel €315 billion to fund EU infrastructure and SMEs, by providing a first loss guarantee with €21 billion of European Commission and EIB capital.
- ▶ The Advisory Hub and the Project Portal also supported by the EIB are key components in developing the wider ecosystem needed to encourage greater investment in infrastructure and SMEs.
- ▶ A similar structure – the European External Investment Plan (EIP) – will support investment in social and economic infrastructure and SMEs in Africa and EU Neighbourhood countries.

**Green Paper on Retail Financial Services**

<b>IMPACT</b>	<b>Providers of cross border financial services such as banks, insurance companies and payment services providers</b>
DEC 2015	European Commission Green Paper on Retail Financial Services published.
Q1 2017	Publication of European Commission action plan on retail financial services expected.

**IMPACT ON INVESTORS, AND BLACKROCK VIEW**

In December 2015, the European Commission published a Green Paper for consultation, aiming to assess how the European market for retail financial services – namely insurance, loans, payments, current and savings accounts and other retail investments – can be further opened up. The objective is to bring better results for consumers and firms, while maintaining investor protection. In practical terms, this means making it easier for:

- ▶ Companies based in one Member State to offer retail financial services in other Member States.

- ▶ Consumers to be able to buy retail financial services offered in other EU Member States, especially if this means they can take advantage of more competitive options offered elsewhere in the Union.
- ▶ Citizens to take their financial service products with them if they move from one Member State to another, whether to study, work or retire – so-called "portability".

We support this initiative to remove barriers to cross border provision of services, and recommend that the Commission focusses on:

- ▶ The lack of consistent Know Your Client (KYC) and Anti-Money Laundering (AML) process.
- ▶ The lack of an effective cross-border passport for products other than UCITS and AIFs.
- ▶ Discriminatory withholding tax regimes.
- ▶ Building effective cross-border schemes of redress.

UCITS are an example of a successful pan-European retail product and provides a benchmark for what the successful cross-border distribution on other retail products could look like.

**Key features of the Commission's Retail Green Paper**

- ▶ Better information for customers and help to allow them to switch products through the development of comparison websites.
- ▶ Increasing portability of products.
- ▶ Encouraging compatibility and consumer understanding with improved disclosure standards such as transparency of long-term retail and pension products.
- ▶ Improving redress in cross-border retail financial services
- ▶ Proposals to develop electronic signature and verification of identity through the development of electronic identification procedures and electronic identity.
- ▶ Improving access to and usability of financial data particularly in the area of insurance.
- ▶ Converging procedures for personal insolvency, property valuation and collateral enforcement.
- ▶ Creating new or more closely-harmonised EU products such as the development of a Pan-European Personal Pension Plan (see [page 23](#)).

For more details, see our detailed [response to the European Commission's Green Paper on Retail Financial Services](#).

## ENVIRONMENTAL, SOCIAL, AND GOVERNANCE FACTORS AND IMPACT INVESTING

Environmental, Social, and Governance (ESG) factors are increasingly important considerations for investors globally. Broadly speaking, ESG refers to the integration of environmental, social, and governance factors in the investment process; this spans a range of issues, for example climate risks, labour and human rights issues, and corporate governance arrangements. Many companies now explicitly identify, manage, and report on ESG issues. Industry-led efforts to establish ESG reporting and analytical guidance are becoming more refined as collective experience increases.

Policymakers are also looking at ESG factors as a means to promote sustainable business practices and products. Investors increasingly see its value as a potential indicator of operational quality, efficiency, and management of long-term financial risks. Today, investors can integrate ESG factors in three primary ways:

- 1. Traditional investing:** ESG factors can be included in financial analysis to evaluate risks and opportunities, not to apply social values to investment decisions, but to consider whether they add or detract value from an investment.
- 2. Sustainable investing:** ESG objectives are explicitly incorporated into investment products and strategies. The spectrum of strategies reflects the wide range of investor objectives, from divesting from specific sectors (e.g. tobacco), to targeting positive social and environmental outcomes (Impact Investing). Managers can apply ESG screens, remove an ESG factor from a portfolio, e.g. companies violating labour laws, or maximise exposure to highly-rated ESG companies.
- 3. Investment stewardship:** This engagement with companies aims to protect and enhance the long-term value of clients' assets. Through dialogue and proxy voting, investment managers engage with business leaders to build understanding of the risks and opportunities facing companies and expectations of how these risks will be mitigated and opportunities leveraged.

ESG-related themes and requirements touch on a wide range of EU legislative initiatives and policy areas. While some focus on ESG considerations as part of stewardship and corporate governance processes, other initiatives seek to promote specific types of sustainable, or 'green' investment:

**EU Capital Markets Union:** Promoting increased markets-based finance, and includes specific measures on financing green investment (e.g. green bonds), infrastructure investment. The Commission is likely to convene an Expert Group on Green Finance by the end of 2016 to identify potential opportunities to develop a framework for sustainable investment. The Commission has started a process to set up an expert group (including industry stakeholders) that will help develop an EU strategy on Sustainable Finance. The expert group will kick off in January 2017 and is expected to develop a policy roadmap by January 2018.

**EU Energy Union:** This strategic initiative aims to create a single EU energy market, incorporating climate goals and financing low-carbon technology. A framework is expected to be in place by 2019, aiming to meet targeted 27% reduction of energy usage and a 40% reduction of greenhouse gas emissions in the EU by 2030.

**European Fund for Strategic Investments (EFSI):** Launched in 2015, this European Investment Bank (EIB) managed €315 billion fund (public sector guarantees and private co-investment) is aimed at financing strategic infrastructure projects in EU, with a strong focus on sustainable energy. The Commission has proposed a 3-year renewal of EFSI (see [page 11](#)), as well as earmarking 40% of EFSI's infrastructure and innovation window to climate related projects.

**EU Non-Financial Reporting Directive:** Legislation requiring disclosure of a range of ESG-related information by listed companies and other designated entities with 500+ employees will apply from January 2017.

**ESG and Fiduciary Duty initiatives:** Measures to promote ESG factors as part of investor fiduciary responsibility and encouraging more disclosure of ESG information by companies, are currently under consultation, and will feed into guidelines supporting the Non-Financial Reporting Directive – due to be published in December 2016.

**Product disclosure initiatives:** Various financial product (especially funds) disclosure rules (UCITS and PRIIPs KIIDs) include provisions on disclosure of ESG policy.

For more details, see our *ViewPoint*: [Exploring ESG: A Practitioner's Perspective](#) or visit BlackRock's [Investment Stewardship hub](#).

# Market structure and liquidity

## MiFID II: Market Structure & Trade Execution

<b>IMPACT</b>	<b>Many of the new requirements are intended to be positive for the market as a whole. The changes will create inevitable challenges to firms to implement while the impact on market efficiency and liquidity is still to be determined given the detailed rule making is still to be agreed</b>
MAY 2016	MiFID II Delegated Acts published.
Mid-2016	European Commission endorsement of Regulatory Technical Standards (RTS).
2016-17	Domestic rulemaking incorporating MiFID II into Member State law – ongoing throughout 2016 – 2017.
2017	Commission work on post-trading to be stepped up. A consultation on removal of barriers to cross-border investment is expected.
JAN 2018	MiFID II takes effect.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

The Markets in Financial Instruments Directive II (MiFID II) updates the existing market structure regulatory regime in Europe, and will include the introduction of pre-and post-trade transparency requirements for ‘equity-like’ instruments (i.e. Exchange Traded Funds (ETFs)) and ‘non-equity’ instruments (fixed income, structured finance products and derivatives). These will apply across all trading venues.

The new transparency regime will be tailored to the instruments in question. Unlike equities, the ‘non-equity’ space is extremely diverse, typically fragmented and inventory-based, with low or dispersed liquidity (particularly in secondary market trading of corporate bonds) so it is particularly important that the regime applying to fixed income recognises the liquidity profile of the underlying instrument. We raised concerns that an inappropriate classification of fixed income instruments, whereby illiquid instruments are deemed to be liquid, could undermine the efficient allocation of capital from investor to company. We made recommendations to minimise the impact of these requirements on investors, companies and overall market efficiency. ESMA has since revised its approach, and the final rules take a different approach to classifying thresholds with the result that the thresholds are now more bespoke to the type of instrument, and are regularly updated to capture market changes.

MiFID II should deliver the long-awaited pan-European consolidated tape (trade reporting) for equity and ‘equity-like’ instruments such as ETFs, which is intended to offer the most current information available and be accessible on a “reasonable commercial basis”, with prices disclosed throughout the trading day. We support this consolidated view of liquidity, which will facilitate more informed price discovery and could lead to increased liquidity across European markets. Further, this will help investors gain a more complete picture of an equity and ‘equity-like’ instrument’s liquidity across venues.

### Key features of the MiFID II rules impacting market transparency

- ▶ The current pre- and post-trade transparency regime of shares admitted to trading on a regulated market will be applied to non-equities (fixed income, structured finance products and derivatives).
- ▶ The pre- and post-trade transparency regime for shares is extended to cover depositary receipts, ETFs, certificates and other similar financial instruments traded on a regulated market or multilateral trading facility.
- ▶ Trading under the reference price waiver and negotiated transactions made within the current weighted spread on the order book will not be able to exceed 8% of total trading in a given share on all EU trading venues where the share trades. There is also a cap at 4% for use of these waivers by an individual trading venue.
- ▶ Trading venues will need to make information about trading interest in “non-equity” (i.e. bonds and derivatives) publicly available. This obligation will not apply where there is not a liquid market for an instrument, an order is large-in-scale compared with normal market size, is held in an order management facility or is trading interest above a size that would expose liquidity providers to undue risk (as long as indicative prices are publicly disseminated).
- ▶ Details of non-equity transactions on trading venues must need to be published as close to real-time as possible.

### Shareholder Rights Directive (SRD): Transparency and long-termism

<b>IMPACT</b>	<b>Pension funds, insurance companies, listed companies and asset managers</b>
APR 2014	European Commission proposal published.
OCT 2015	Start of the political negotiations between European Parliament, Member States and European Commission.
2017	Political agreement expected between the three institutions on the basis for the Directive.
Once political agreement is reached, Member States will have 18 months to adopt the Directive into national law.	

## IMPACT ON INVESTORS, AND BLACKROCK VIEW

Under SRD, insurers, pension funds and asset managers will be required to provide greater transparency of their shareholder engagement policy and how they engage with companies they invest in, and their equity investment strategy. The aim is to incentivise long-term focus and improve corporate governance across Europe.

The proposal requires asset managers and institutional investors to disclose a detailed shareholder engagement policy, including voting records. We support this and believe disclosure should provide relevant meaningful information, that enables the public to understand how asset managers and asset owners apply their corporate governance principles. Excessive detail, such as the proposed explanation of the voting rationale for each vote cast, will obscure the overall picture.

SRD requires institutional investors to publicise their equity investment strategy. In line with their fiduciary duty towards their clients, we believe that the disclosure requirement should be addressed to their clients (the pension fund members and insurance policyholders) rather than the general public.

SRD introduces measures to align executive remuneration with the long-term business strategy and interests of the company. We support this. Too great a focus on pay may divert shareholder and company attention away from a wider range of governance issues (such as board composition, succession planning, operational excellence, business strategy and execution), which are critical to sustainable long-term business performance.

### Key features of the Commission proposal on SRD

- ▶ Institutional investors and asset managers to publicly disclose their shareholder engagement strategy on an annual basis.
- ▶ Institutional investors to publicly disclose their equity investment strategy and certain elements of their arrangement with asset managers.
- ▶ Asset managers to disclose to institutional investor clients their investment strategy and its implementation.
- ▶ ‘Say on pay’ required for the portfolio company remuneration policy and remuneration report.
- ▶ Public statement and independent report to be released when a material related party transaction is concluded. Shareholder vote on material related party transactions optional.
- ▶ Increased transparency of proxy advisors through disclosure of methodologies and information sources for their voting recommendations. Intermediaries should offer

to companies the possibility to have their shareholders identified and facilitate the exercise of the voting and general meeting participation rights by shareholders.

## Benchmarks and Market Indices Regulation

IMPACT	Benchmark providers and submitters. Limited impact on the users of benchmarks
APR 2013	IOSCO Principles for Financial Benchmarks published.
JUN 2016	EU Benchmarks Regulation published in the Official Journal and EU critical benchmark regime takes effect.
APR 2017	ESMA Regulatory Technical Standards (RTS) published.
JUN 2017	European Commission adopts RTS. Delegated Acts published.
JAN 2018	All other provisions of EU Benchmarks Regulation take effect.

## IMPACT ON INVESTORS, AND BLACKROCK VIEW

The role benchmarks play in the pricing of many financial instruments makes protecting them against the risk of manipulation vital. Broad in scope, the Benchmarks Regulation captures all financial benchmarks and market indices. Its requirements apply to administrators, submitters and users of critical benchmarks such as interest rate benchmarks that have demonstrated obvious weaknesses (i.e. LIBOR, EURIBOR), right through to asset managers who may produce composite indices for performance benchmarking purposes.

While supporting the policy intent of ensuring the integrity of benchmarks, we have recommended that a qualitative risk-based approach should be at the heart of the Regulation. We do not see justification to include all indices and benchmarks in the same regulatory regime. Proportionality is key, and this principle should be honoured in the detailed rule making coming up in 2017.

For non-critical benchmarks, such as market indices, we have suggested a proportionate focus on providers, rather than individual benchmarks. It will be challenging to identify each benchmark, let alone authorise and regulate the estimated one million plus indices and benchmarks that are currently used in Europe.

In our view, the global IOSCO Principles for Financial Benchmarks should be the basis by which the non-critical benchmarks could be deemed equivalent with other jurisdictions. It appears unlikely that jurisdictions other than the EU will introduce comparable legislation to regulate all indices and benchmarks and to similar levels of intensity.

## Key features of the Benchmarks and Market Indices Regulation

The Benchmarks and Market Indices Regulation sets out to:

- ▶ Improve the governance and controls over the benchmark administration and compilation process
- ▶ Improve the quality of the input data and methodologies used by benchmark administrators
- ▶ Ensure that contributors to benchmarks provide adequate data and are subject to adequate controls
- ▶ Ensure adequate protection for consumers and investors using benchmarks
- ▶ Ensure the supervision and viability of critical benchmarks
- ▶ It is important to note that comparable legislation seeking to regulate the administration of, submission of data to and use of benchmarks does not currently exist outside of the EU legislative process, creating problematic market access issues for non-EU benchmark providers.



## EUROPEAN CORPORATE BOND MARKET LIQUIDITY

Corporate bond market structure and liquidity continues to be a priority for regulators and investors around the world. However, much of what shapes the lively debate about liquidity in European fixed income markets has been hitherto based on what is known from US bond markets given the data bias in this market. While some of the comparative data cited between the two regions are factually correct, it is important to evaluate European market liquidity in the context of European market structure, to appreciate what is driving innovation and change on the ground.

Key features of market liquidity in European fixed income markets

▶ **European corporate bonds trade less than their US equivalents**

This is mainly because the market is still small relative to the size of the economy and lacks a larger institutional investor base, as is the case in the US. Also, the lack of consistent and reliable trade reporting data makes it harder to assess the true level of secondary market liquidity in Europe.

▶ **The European Central Bank continues its quantitative easing programme, adding corporate bonds to the mix**

This decision has driven the strong performance of European corporate bonds in 2016. Simultaneously, it has become more difficult and expensive for private investors to find the bonds they need to buy. Some are therefore increasingly looking to invest internationally, mainly in higher yielding US denominated assets and emerging market debt.

▶ **Bid-ask spreads are becoming less meaningful**

Banks under the traditional broker-dealer model are less willing to intermediate and hold risk on their balance sheet. Instead, they are moving towards a more riskless type of business model, where they are compensated for facilitating trades, often referred to as agency trading. Under this new regime, low and stable bid ask spreads are becoming less meaningful as a liquidity metric, given that investors typically have to sacrifice immediacy and delay the trade until the broker-dealer has found the other side of the market.

▶ **Market participants are adapting to structural and cyclical changes**

The trading landscape and transparency in EU capital markets is evolving fast and in similar ways to the US. Among the most noteworthy changes is the rising popularity of alternative credit vehicles such as bond ETFs, and greater adoption of electronic trading in fixed income, including trading venue and protocols. In fact, according to a Greenwich survey, electronic trading of corporate bonds is estimated to be higher in Europe than in the US.<sup>6</sup>

▶ **European investors have increased bond ETF adoption.**

European investors are buying bond ETFs at a record pace as they look for more liquid and standardised products that help them address liquidity challenges in fixed income markets. European listed bond ETFs represent \$150 billion in AUM and 2016 has seen the fastest growth rate in global bond ETFs since 2012, with European and US markets tripling in size over the last six years<sup>7</sup>.

In our view, growing the public debt markets as an important source of financing for European companies, and is at the heart of the European Commission's Capital Market Union initiative. This should encourage a wider investor base in corporate bonds and could lead to a renewed impetus to harmonise debt issuance regimes across Europe.

For further detailed analysis, please our **ViewPoint**: [Addressing Market Liquidity: A Broader Perspective on Today's Euro Corporate Bond Market](#).

# Distribution

## MiFID II: Regulation creating a new model of distribution?

IMPACT	Retail investors and institutional investors, distributors, wealth managers and asset managers
OCT 2011	Proposals for an updated Markets in Financial Instruments Directive (MiFID) and a new Markets in Financial Instruments Regulation (MiFIR), collectively known as MiFID II.
JAN 2014	Political agreement reached on MiFID II.
Q1 2016	Draft Delegated Acts published.
OCT 2016	ESMA Consultation on Product Governance published.
JAN 2018	MiFID II takes effect.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

The Markets in Financial Instruments Directive II (MiFID II) aims to enhance investor protection in existing distribution channels through upgrades to client servicing models. While we still await the specific details to be set out in EU and national implementing rules, it is clear MiFID II represents significant change for many firms.

Key to enhancing the investor's experience are changes to suitability rules. These include requirements to ensure that point of sale assessments are regularly updated to ensure distributors maintain an accurate picture of both the client's risk profile and investment portfolio. We believe that justifying the relative cost and complexity of products in the client's portfolio and understanding the relevant target market for specific products will lead to improved risk profiling. The forthcoming target market rules from MiFID, and guidance from ESMA, will lead to greater exchange of data between manufacturers and distributors. Product manufacturers will need to provide more data on how their products are designed to perform and build more holistic product development processes drawing on a greater understanding

of end investors' needs and distributors will need to provide data on whether products have been sold as intended.

MiFID II will encourage greater alignment of interests between investors and managers/advisors, firstly, by preventing the retention of commission by independent advisers and discretionary portfolio managers, and secondly, requiring that commissions paid to non-independent advisers or execution-only platforms are designed to enhance the quality of the service to the client. Commission and other payments must not prevent a firm from acting fairly and professionally in the best interest of its clients.

There is a risk that the additional obligations under MiFID II price out mass retail investors from accessible advice, creating an advice gap. Regulators and industry are actively considering how the mass market will access financial advice in the future, especially through the use of technology such as automated or 'robo' advice.

### Key features of MiFID II on distribution

#### Investor protection

- ▶ Target market analysis for product sales.
- ▶ Revised suitability and appropriateness regime especially for 'complex' products. Enhanced focus on the relative cost and complexity of products and greater focus on the ongoing suitability of products.
- ▶ Ban on retention of inducements by independent advisers and discretionary portfolio managers.
- ▶ Quality enhancement required for non-independent advisers and execution only platforms to retain commission.

#### Cost disclosures

- ▶ Transparency to the client on the total cost of investing including total costs charged by the MiFID firm for services such as advice/management and the costs charged by the products in which the client is invested (see [page 21](#)).

#### Product governance

- ▶ Product manufacturers are required to enhance their processes and build greater connectivity with intermediaries especially in respect of the target market for their products.

## A patchwork of national retail distribution reviews to implement MiFID II

IMPACT	Retail investors, distributors, manufacturers
Present – 2018 (mostly throughout 2017)	In 2016, the European Council and Parliament agreed to delay the implementation of MiFID II by one year, to January 2018, as a result of delayed implementing rules. Most Member States will update their retail distribution regimes as part of their national implementation of MiFID II. The UK (2013) and the Netherlands (2013 / 2014) moved ahead of MiFID to bring in wider-ranging commission bans.

### NATIONAL RETAIL DISTRIBUTION REVIEWS AND IMPLEMENTATION OF MIFID II

#### EARLY MOVERS



#### United Kingdom

The Retail Distribution Review (RDR), implemented in 2013, included higher standards of qualification for advisers and a ban on commissions between product providers and fund distributors on new business, forcing advisers to adopt fee-based models. The ban will extend to discretionary portfolio managers with the introduction of MiFID II.



#### Netherlands

A ban on payment of commission for mortgage credit, income insurances, unit-linked insurances, annuities and non-life insurances took effect in January 2013. Inducement ban in respect of investment services to retail came into force on 1 January 2014. The Dutch regulator is also closely monitoring the use of fund of fund products to ensure managers include an appropriate range of third party funds.

#### FOCUS ON PROMOTING INDEPENDENT ADVISERS AS A COMPETING BUSINESS MODEL



#### Sweden

Sweden consulted widely on a commission ban that would have gone further than MiFID II – and looked set to become an early adopter. However, a decision was reached in 2016 not to do so at this stage. Sweden is expected to propose new legislation in early 2017 to implement the requirements of MiFID II. It is still under consideration whether MiFID requirements will be applied to insurance intermediaries under the IDD in order to ensure a level playing field for cost transparency and management of conflicts of interest.



#### Denmark

Having reviewed the impact of RDR in the UK and Netherlands, as well as deliberations in Sweden, Denmark also decided in 2016 not to introduce a ban on retrocessions ahead of MiFID II. Instead, the regulator will focus on product transparency.



#### Belgium

Unlikely to move beyond MiFID II. Key focus remains on banning unsuitable products and ensuring distributors apply more stringent suitability tests.



#### Germany

The Facilitation and Regulation of Fee-based Investment Advice Act (August 2014) introduced a legal framework for fee-based investment advice in financial instruments which can be offered by investment services enterprises. This is in addition to ordinary MiFID investment advice based on the disclosure of any commissions received by advisers from issuers of financial instruments or intermediaries. Recent announcements of loosening up on the record keeping requirements on suitability. German implementation of MiFID II proposes an additional ground for quality enhancement, namely the provision of advice through a branch network in regional areas. Smaller entities advising on a limited product range will remain exempt from the full scope of MiFID II.



#### France

France supports a ban on commissions for discretionary portfolio management and has for many years banned commission payments to managers of funds of funds. Many concerns regarding the effect on access to advice raised by too strict an interpretation of the quality enhancement rules. The French regulators is also following the development of independent digital advice as a way of encouraging greater competition in the market.



#### Italy

Italian market moves to a dual system of fee-based and commission-based advisers. A ban on discretionary, managed fund platforms receiving commission has been in place since the introduction of MiFID I. Otherwise Italy is not expected to move beyond MiFID II.

#### BEYOND THE EU



#### Switzerland

The Federal Financial Services Act (FIDLEG) is intended as Switzerland's equivalent of MiFID II. Although designed to improve consumer protection through a much tighter distribution regime, this does not include a ban on commissions for investment advisers. Not expected to come into force before January 2018. Moves towards fee-based advice in the wealth sector are driven more by commercial than regulatory pressures.

## UCITS: Cross border distribution and asset segregation

IMPACT	Retail investors and institutional investors, distributors, wealth managers and asset managers
JUN 2016	European Commission consultation of barriers to cross border distribution of funds.
JUL 2016	ESMA published second consultation on asset segregation.
Q4 2016	European Commission Expert Group expected to meet to take stock of Member States' commitments and finalise the roadmap of agreed actions.
Q1 2017	European Commission proposals to reduce barriers to cross border distribution of investment funds expected.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

In 2016 ESMA and the European Commission have been looking at a number of reforms to the UCITS fund regime.

ESMA has been considering introducing full physical segregation of UCITS fund assets along the whole custody chain. We support ESMA's goal of identifying the most appropriate model for the safe-keeping of client assets. This would compromise a number of operational procedures, and in particular, impact firms using the triparty custody mechanism for repo and securities lending programmes. However, in our view, full segregation would add significant complexity to the reconciliation, settlement and exceptions management process. We therefore favour allowing commingling of client assets in sub-custody accounts provided robust reconciliation processes are in place, or allowing funds to choose their model.

The Commission has also consulted on barriers to the cross border distribution of funds, including UCITS, covering costs and procedures of registering funds, tax, administration and marketing.

In our view, Member States' local pre-approval of marketing material should be phased out over time with the development (by ESMA) of detailed cross-border marketing guidelines. These could include definitions of commonly used terms, a mechanism to update rules and guidance to reflect new marketing technologies, examples of good practice, standard compliance templates and time limits for Member State pre-approval of cross-border marketing material. While UCITS IV represented a valuable step forward in coordinating administrative processes we believe that ESMA can play a

far more active role in the future by acting both as a hub of notifications of cross border distribution and by setting a common set of marketing standards. This would further reduce the complexity of distributing funds cross border without reducing the level of investor protections.

In terms of tax treatment, barriers include discriminatory Withholding Tax (WHT) treatment between residents and non-residents in some states; differing approaches to tax reporting; and inconsistent and cumbersome Double Taxation Treaty (DTT) access for investment funds. We recommend convergence and better DTT access.

In our view, the requirement to retain a local facilities and paying agents for funds is outdated, given that technological developments mean that access to information, payments and issue handling services can be provided by other means. Managers should have the option to use online and telephone alternatives, as has been accepted by the Commission as part of the new ELTIF regime.

### Key features of UCITS reform

#### Asset segregation

- ▶ In our view, segregation through the custody chain at the Depository/AIF/UCITS level, beyond what exists today, would result in a spike in the number of accounts, increasing complexity. Ongoing maintenance costs may be passed to investors, without greater asset protection in exchange.
- ▶ Structures such as those used for the HK/SH Stock Connects market, or markets which have historically used an omnibus account model such as DTCC, may be incompatible with ESMA's asset segregation proposal.

#### Barriers to the cross border distribution

- ▶ Marketing: Differing national marketing requirements are costly to research and meet.
- ▶ Distribution costs and regulatory fees: Regulatory fees imposed by home and host states cumulatively can act as barriers.
- ▶ Administrative arrangements: Some special arrangements originally intended to make it easier for investors to obtain information, subscribe, redeem and receive related payments from a local bank, are no longer justified in the light of an effective pan-European payment systems and Internet-based information portals.
- ▶ Taxation: Differing tax treatments can create barriers to cross border business.

For more details, see our [response to the Commission's Consultation on Barriers Cross Border Distribution](#).

## Cost transparency: MiFID, PRIIPs and Pensions

IMPACT	Individual and institutional investors including pension funds, product manufacturers, advisers, consultants and distributors
ON GOING	At EU level PRIIPs Regulation is designed to give enhanced transparency to purchases of packaged retail products and MiFID II aims to give full transparency of all costs in the intermediary chain such as product, advisory platform, custody and other costs).
	UK pension schemes that are already subject to value for money obligations require enhanced disclosures ahead of finalisation of DWP/FCA and industry standards.
	In the UK, the FCA's interim report on asset management proposes a number of options as to how fund costs are reported, with the introduction of an all in fee for retail investors. HM Treasury (HMT) and Department of Work and Pensions (DWP) are also consulting on the standards for reporting costs to trustees and independent governance committees of default Defined Contribution (DC) pension schemes. Similar rules are being developed for cost disclosure to local government pension schemes.
	The European Commission has brought out proposals to the implementation of PRIIPS by a year, to 31 December 2017.
JAN 2018	MiFID II takes effect.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

Both the EU, and the UK at national level, are proposing various measures aimed at increasing transparency over the total cost of investing. We welcome the development of a standardised and meaningful approach to reporting on costs, particularly transaction costs. Correctly designed, this will help investors to compare the relative cost and performance of competing investment products and investment services such as investment advice and discretionary management.

Regulatory guidance should be as specific as possible to avoid the risk of investors being misled. Figures should be derived from the same building blocks in order to deliver a consistent approach, allowing investors to compare the value for money they receive from different providers.

The key challenge is developing a standard methodology for reporting on transaction costs. By this we mean the costs incurred by portfolio managers in buying or selling securities inside a fund. These arise as a result of investor flow, index

rebalances, new investment ideas, or the ongoing risk management of a fund. All of these activities result in trading, and the costs that arise because of that trading are transaction costs. Investors care about the net performance they receive after fees, expenses and taxes. Transaction costs do not refer to the bid-ask spread which occur when investors themselves buy or sell units in a fund. Many funds operate an anti-dilution mechanism that protects existing investors.

Transaction costs are important because they apply a brake to that performance. They can be either explicit with easily accessible data which can be used to report to investors or implicit where managers have developing a variety of different methodologies and estimates to account for these costs. The development of more standardised data sets and reporting methodologies will assist in the provision of standardised data disclosure.

A workstream is expected at ESAs level to look into product disclosure and transparency – although no timing has been fixed yet. As the Commission is planning to undertake an horizontal review of retail products in 2018, transparency and comparability will be the two key elements the Commission will be focusing on.

#### Key features of MiFID cost transparency measures

- ▶ MiFID II will introduce new cost transparency standards both at the level of the product and distributor.
- ▶ MiFID II includes distribution costs incurred through the aggregation of charges, distribution and transaction costs, product charges and both explicit and implicit transaction costs.
- ▶ A key change will be the presentation of costs in a currency (e.g. €/£ amount as a proportion of a nominal €10,000/£10,000 investment amount) as well as percentage disclosures.

#### Key features of PRIIPS cost transparency measures

- ▶ The PRIIPS regulation will require disclosure of summary indicators and aggregation of product charges and transaction costs as well as both explicit and implicit transaction costs.
- ▶ We believe that a number of changes are required to disclose costs and charges in a meaningful way. As it stands costs are to be shown as the impact on return per year obscure potentially significant one off costs such as entry fees.
- ▶ Execution costs also need to be separated from market impact costs. The proposed arrival price or slippage cost methodologies may have the unintended consequence of showing negative costs and therefore obscure actual costs to a fund of dealing on the market.

## DIGITAL INVESTMENT ADVICE: ROBO ADVISORS COME OF AGE

Digital advisors incorporate web and model based technology into their portfolio management processes – primarily through the use of algorithms designed to optimise various elements of wealth management from asset allocation, to tax management, to product selection and trade execution. As savers grapple with global and geopolitical uncertainty, prolonged low and negative interest rates, and longer lifespans, the need for financial advice has never been greater. Regulators such as the UK Financial Conduct Authority (FCA) are increasingly looking at the recent rapid growth of digital advisors to improve the affordability and accessibility of advice while assessing whether there are new regulatory risks.

In 2016, the European Supervisory Authorities (ESAs, including the EBA, EIOPA and ESMA) published a Discussion Paper on automation in financial advice, seeking comments on the potential benefits for both consumers and firms but also on a number of potential risks and confusion over business models. With regulators growing interest in financial technology, further initiatives on automated advice are expected from both European and national regulators looking to support the growth of the industry as a way of increasing the affordability and accessibility of financial advice while also tackling perceived risks.

Automated advice also refers to the use of 'big data' and personal data by the financial services industry. In May 2016, the EBA issued a consultation on uses of consumer data by financial institutions. The consultation notably refers to the potential of data analytics for automated advice, especially with regards to 'robo-advice'. The outcome of the consultation is expected to feed into the joint ESAs work on big data.

### BlackRock view

Digital advisors are subject to the same framework of regulation and supervision as traditional advisors; however, the applicability and emphasis may differ in some cases. Regulatory guidance should focus on the following core factors:

1. **Know your customer and suitability.** Suitability requirements across the globe require advisors to make suitable investment recommendations to clients based on their knowledge of the clients' circumstances and goals, which is often gained from questionnaires. These rules apply equally to digital advice, though the means of assessing suitability may differ somewhat.
2. **Algorithm design and oversight.** Digital advisors should ensure that investment professionals with sufficient expertise are closely involved in the development and ongoing oversight of algorithms. Algorithm assumptions should be based on generally accepted investment theories, and a description of key assumptions should be available to investors in a plain language form. Any use of third party algorithms should entail robust due diligence before the algorithms are provided to the consumer.
3. **Disclosure standards and cost transparency.** Disclosure is central to ensuring that clients understand what services they are receiving as well as the risks and potential conflicts involved. Like traditional advisors, digital advisors should clearly disclose costs, fees, and other forms of compensation prior to the provision of services. Digital advisors should similarly disclose relevant technological, operational, and market risks.
4. **Trading Practices.** Digital advisors should have in place reasonably designed policies and procedures concerning their trading practices. Such procedures should include controls to mitigate risks associated with trading and order handling, including supervisory controls. Risks associated with trading practices should be clearly disclosed.
5. **Cybersecurity and data protection.** Digital advisors must be diligent about sharing and aggregating only information that is necessary to facilitate clients' stated investment objectives. Digital advisors should conduct vendor risk management, obtain cybersecurity insurance, and implement incident management frameworks, including understanding and complying with the evolving regulatory requirements in the relevant jurisdictions.

For more details, see our *ViewPoint*: [Digital Investment Advice: Robo Advisors Come of Age](#).

# Retirement

## A summary of national pension reform

Changing demographics and low interest rates have resulted in a need to revitalise pensions systems and develop greater personal engagement in many Member States. Statutory retirement ages are edging up, with 67 becoming the new 65, and further increases often linked to national longevity.

At a European level, the Commission is exploring whether a Pan-European Personal Pension (PEPP) product (see [page 23](#)) could help EU citizens to save, and the proposal for the Occupational Retirement Provision Directive (see [page 24](#)) seeks to ensure standards of governance and transparency for workplace schemes. National level measures include:

In the UK, employers are required since 2012 to enroll their employees into a pension scheme automatically, unless an employee actively opts out. This 'nudge' has increased by 6 million<sup>8</sup> the number of workers with a workplace pension. A review of this initiative in 2017 offers the opportunity to further address the savings gap with auto-escalation tools that gradually increase contribution rates. Since 2015, the requirement to annuitise pensions at retirement has been removed, and from 2017, the new Lifetime-ISA – a tax-free savings product – will incentivise long-term saving with government top ups for targets met.

In Germany, while rates of saving are already high – 69% have started saving for retirement – , most of this is held in cash<sup>9</sup>. With interest rates low, this is unlikely to provide sufficient retirement income for most. The government is expected to present new proposals by end of 2016, focusing on reforms to state pensions, and increasing the attractiveness and availability of workplace schemes. Flexibility around the retirement age is under consideration, to reward those working for longer, as well as various Defined Contribution (DC) and hybrid models.

In Italy, the 2017 budget includes new measures to enable some limited categories of workers to retire at 63, although the overall statutory retirement age is edging up to 67 by 2019. Following years of reforms, most pension funds – except legacy plans – are DC. Despite the roll back of state provision, participation in workplace schemes is still low, however auto-enrolment in some sector-specific schemes may help increase this.

In the Netherlands, the vast majority of employees are members of workplace pensions, either through corporate or industry-wide schemes that cover entire sectors. Historically these have largely been Defined Benefit (DB), although we see a shift towards DC options. In 2016, pensions freedoms were announced, which will remove the requirement for members of DC schemes to annuitise at 65.

## Pan-European Personal Pension (PEPP)

IMPACT	Individuals looking for a personal pension, insurance companies, asset managers and other pension providers
JUL 2016	EIOPA published advice for the Commission on potential for an EU internal market for personal pensions.
OCT 2016	European Commission consultation and public hearing on a potential EU personal pension framework proposal published.
2017	Pan-European Personal Pension product framework may be published in H1 2017 – the Commission is currently considering feedback to the consultation with a view to determine future legislative and /or regulatory proposals.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

With pension products providing an important link between long-term savings and investments, the European Commission is exploring whether a Pan-European Personal Pension (PEPP) product could play a role in both encouraging EU citizens to save adequately for retirement, and channel those savings into the economy, via companies and projects that deliver a return for the saver.

The PEPP aims to offer a standardised personal pension, with specific authorisation regime for PEPP managers, common rules on product design as well as rules on selling practices to ensure the product meet the best interest of customer. This is intended to complement, rather than replace national schemes, at state level (Pillar 1) as well as workplace schemes (Pillar 2).

We believe that the PEPP as a Pillar 3 product regime with a number of standardised features could be beneficial in addressing the retirement income gap increasingly faced by European citizens. Any future regime needs to contain enough flexibility to recognise that individual retirement savings needs differ between European countries and depend on whether people have pre-existing access to comprehensive Pillar 2 regimes which function well and/or whether a personal pension will need to form a substantial part of savings for future retirement needs.

Key elements of disclosure where consumers will benefit from standardisation include costs, performance and coverage of longevity risk during the decumulation phase. The administrative costs of running the PEPP can be reduced with a focus on using standards data fields to allow pension portability between countries and employers. Tax and social security differences means some national customisation will be necessary. The use of a common European digital identity could help drive the development of reporting and record keeping requirements.

In addition to portability, the PEPP should contain switching rights to allow people to move to a more competitive provider or to consolidate existing plans. Switching rights should not however be so frequent as to inhibit investment in longer term assets. A simplified regime for guidance and advice could allow the development of easy to use tools to support people before they subscribe to a PEPP.

### Key features of the Commission proposal on PEPP

- ▶ The proposal aims to encourage EU citizens to further save for retirement.
- ▶ The attributes currently envisaged for a PEPP include:
  - A high degree of standardisation, in order to set a high minimum standard for product quality and governance
  - Penalties for premature draw down of capital accumulated, to encourage long-term saving
  - A stand-alone authorisation regime for providers, unless already licensed under Solvency II, CRD IV, IORPD and / or MiFID II
  - A Product Passport based on a system of co-operation between competent authorities to allow for easy marketing in host Member States
  - Investment rules regarding quality, liquidity (as necessary given the long-term investment profile to be expected) return and diversification (including pooling of risk)
  - PEPPs should be suitable to be marketed using modern technologies, and sold via the internet
  - The product characteristics and disclosures should be simple enough that limited or no advice is required

For more details, see our [response to the Commission's Consultation on a Pan-European Personal Pension](#).

### IORPD: Reforming European workplace pensions

IMPACT	Workplace pension funds, trustees and governance committees, asset managers and individual workplace pension plan members
MAR 2014	European Commission proposal published.
APR 2016	EIOPA Quantitative Assessment exercise for Risk Assessment and Transparency.
JUN 2016	Provisional agreement reached between the European Parliament and Council.
NOV 2016	Provisional agreement adopted by the Parliament and Council.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

The existing Institutions for Occupational Retirement Provision Directive (IORPD) covers workplace pensions. The 2014 Commission proposal focuses on improving the governance of Institutions for Occupational Retirement Provision (IORPs) (i.e. workplace pension schemes) and increasing transparency towards their members.

The introduction of an annual Pension Benefit Statement (PBS) is a valuable development. However, given the variety of pension funds and members across the EU, flexibility in the format, content and length of the document should be allowed. We recommend different formats for DB and DC schemes, for individual and collective schemes and for active and deferred members.

Smaller funds may struggle with the requirement to appoint an independent person, responsible for internal audit and the updated risk evaluation. The risk evaluation would duplicate many of the asset and liability management practices of workplace pension funds and create high costs without commensurate benefits in terms of additional protection.

The requirement for those running the pension scheme to hold professional qualifications has been replaced with a requirement that the management be collectively adequate in relation to the activities performed for the scheme. While well intentioned, the original proposal could have penalised volunteering member / employer-nominated trustees, thereby reducing the pool of individuals available to act.

The requirement for defined contribution schemes to appoint a depositary is now at the discretion of individual member states. We believe that blanket UCITS-style requirements for a depositary would not have been relevant for contract-based schemes and it is critical that the depositary's duties of oversight do not conflict with those of trustees.

### Key features of IOPRD II proposal

- ▶ A two-page Pension Benefit Statement (similar to the Key Investor Information Document) should be provided annually, setting out the member's balance and contributions, total capital, and target benefits at retirement.
- ▶ Regular risk evaluations should cover the IORPs' funding needs; a qualitative assessment of the margin for deviation; and a qualitative assessment of new or emerging risks.
- ▶ Scheme managers must be competent collectively in relation to the activities performed for the scheme.
- ▶ National discretion on whether IORPs are required to appoint a depositary for safe-keeping of assets and oversight duties where members bear investment risk (i.e. DC schemes).
- ▶ Member States should allow IORPs to invest in long-term instruments not traded on regulated markets and non-listed assets financing climate resilient infrastructure projects.



# Taxation

## BEPS: Implementation via ATAD in Europe

IMPACT	Investors in cross-border pooled funds investing in private assets European Commission
OCT 2015	Final Organisation for Economic Cooperation and Development (OECD) BEPS package published (Actions 1 to 15).
Early 2016	G20 nations and OECD member jurisdictions, including the EU, agreed on a monitoring framework for BEPS. Cooperation is foreseen until end 2020.
JUL 2016	The Commission had committed in its June 2015 Tax Action Plan to implement BEPS within a year. Final EU Anti-Tax Avoidance Directive (ATAD) published 12 months later – implementation by member states begins.
JAN 2019	Member States have until 1 Jan 2019 to bring their national frameworks in line with the majority of ATAD provisions – with the exception of exit taxation (Jan 2020) and interest deduction measures (Jan 2024).

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

The Base Erosion Profit Shifting (BEPS) initiative of the OECD seeks to curb double non-taxation by multinational corporations. In the EU, the European Commission published the Anti-Tax Avoidance Directive (ATAD) as its means of implementing BEPS. We support the goal of addressing excessive tax planning, however, the final OECD proposals of October 2015 inadvertently impact cross-border funds investing in private assets, and ATAD does not provide a safe haven for investors in such funds.

The unintended consequences of BEPS could result in the risk of double taxation for cross-border investment via funds – typically alternative funds investing in SMEs, infrastructure, real estate, and renewable energy. If the principle of tax neutrality between investing directly or via funds is undermined through an additional tax burden, investments channeled by these vehicles into companies and projects will be reduced.

In our view, this will have a chilling effect on investment, with Europe particularly impacted, given the highly integrated cross-border nature of the Single Market. A path has not emerged in the OECD or Europe to address this. We urge Member States to request that the Commission propose a comprehensive European fund framework linked to a taxation regime that enables funds to continue to invest in assets such as infrastructure and SMEs cross-border, and delivers a balanced and principled outcome to both investors and tax authorities.

Mainstream funds such as UCITS also increasingly face taxation barriers. More are being denied treaty relief at source, creating double taxation where refund claims are not successful. They also increasingly face inconsistent investor tax reporting requirements between Member States. We therefore welcome the Commission focusing attention on gathering best practices and developing a code of conduct to simplify and harmonise withholding tax reliefs. We also urge the development of a common EU tax reporting platform.

Solutions are possible, and we must explore them to avoid a negative impact on European growth and diminishing the success of initiatives such as the ELTIF, EFSI and the CMU.

### Key features of BEPS

- ▶ BEPS consists of 15 work streams ('Actions') to equip governments with the domestic and international instruments needed to implement BEPS.
- ▶ Action 15 (multilateral instrument) is the only outstanding work stream.
- ▶ The Action most relevant to mainstream funds is Action 6 (treaty relief).
- ▶ Alternative funds may additionally be impacted by Action 2 (hybrid mismatches), Action 4 (interest deductions) and Action 7 (permanent establishment).
- ▶ For more information please see our detailed [ViewPoint BEPS: Eliminate Double Non-Taxation Without Impeding Cross-Border Investment](#).

## Financial Transaction Tax (FTT)

IMPACT	All asset owners investing in funds impacted by FTT
FEB 2013	Commission proposal for an FTT under the enhanced cooperation procedure.
JAN 2017	Momentum has slowed down among the 10 pro-FTT EU Member States to agree back in June. Discussions expected to resume in January.

### IMPACT ON INVESTORS, AND BLACKROCK VIEW

The initial policy objectives behind a pan-EU Financial Transaction Tax were to ensure that financial institutions make a fair and substantial contribution to covering the costs of the 2008 financial crisis and to disincentivise transactions that do not enhance the efficiency of financial markets. Eight years after the crisis, an EU FTT is still on the table between the now 10 Member States still in favour of creating an FTT zone.

Political agreement has been elusive due to a lack of agreement on various issues of scope and implementation. Although agreement on a compromise package deal at political level had seemed possible by end of 2016, several deadlines for political agreements have been missed. In addition, concerns expressed by some smaller Member States have caused doubts about the viability of the FTT project. Work is still needed at technical level, and discussions are now set to resume in January.

BlackRock is opposed to any financial transaction tax as it will impact the end-investor as well as financial institutions. The extent to which end-investors will be impacted will depend on the final form of the FTT. A common agreement on the final shape of the FTT has not been reached yet and there is still no clarity on the principle(s) the tax will be raised on (issuance vs. residence principles or a mix of both), the scope of derivatives, the potential exemptions (including treatment of intermediaries / market makers) and the tax collection mechanism and liabilities.

As it stands, end-investors will be hit directly because of the cost of the FTT on the transactions undertaken in their portfolios, and indirectly because the 'trading spread' will increase. If the FTT applies to client redemptions from pooled investment vehicles, the FTT will breach the principle

that investing via investment funds should be tax-neutral compared to direct investment in the underlying fund assets.

### Key features of the FTT proposal

- ▶ The 10 pro-FTT Member States are: Austria, Belgium, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain.
- ▶ Financial institutions based in the 'FTT-zone' (residence principle) are taxable on any transactions they carry out (both the purchase and sale of shares and bonds, as well as derivatives contracts).
- ▶ Financial institutions domiciled outside the zone are chargeable when they trade with a party based in the zone or on an instrument issued in the zone (issuance principle).
- ▶ All securities are in scope on each leg of a transaction: Equities and bonds are chargeable at 10 bps; Derivatives are chargeable at 1bps, but corresponding physical hedges, collateral movements carry the full 10 bps charge.
- ▶ No relief for the intermediaries involved in the transaction chain.
- ▶ France and Italy implemented a domestic FTT in 2013. The pan-EU FTT will supersede national FTTs, once implemented.

# Conclusion

BlackRock supports the creation of a regulatory regime that increases transparency, protects end-investors, and facilitates responsible growth of capital markets, while preserving consumer choice and balancing benefits versus implementation costs. This means seeking to ensure that policymakers' thinking in Brussels and in other European capitals remains consistent and investor-centric, and that the policy objectives meets our clients' needs.

We continue to advocate for our clients and contribute to legislators' thinking for policies that bring about positive change for investors.

To find out more about individual regulatory issues or discuss joint engagement with us, please contact your BlackRock relationship manager, or the European Public Policy team, at [GroupEMEAPublicPolicy@BlackRock.com](mailto:GroupEMEAPublicPolicy@BlackRock.com).

## RELATED CONTENT

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*ViewPoint* – [The European Capital Markets Union: An Investor Perspective](#) – Feb. 2015

Comment letter – [Barriers to the Cross-Border Distribution of Investment Funds Across the EU - EC](#) – Oct. 2016

Comment letter – [Consultative Report on Resilience and Recovery of Central Counterparties - CPMI-IOSCO](#) – Oct. 2016

Comment letter – [Consultative Document on Proposed Policy Recommendations to Address Structural Vulnerabilities for Asset Management Activities - FSB](#) – Sept. 2016

Comment letter – [Joint Committee Discussion Paper on Automation in Financial Advice - ESAs](#) – Mar. 2016

Comment letter – [Green Paper on Retail Financial Services - EC](#) – Mar. 2016

Comment letter – [Call for evidence on the EU regulatory framework for financial services - EC](#) – Feb. 2016

## FOR MORE INFORMATION

For access to our public policy commentaries, including the *ViewPoint* series and comment letters to regulators, please visit [www.blackrock.com](http://www.blackrock.com).

## Endnotes

1 Jean Claude Juncker, President, European Commission, State of the Union address, September 2016

2 G20 Pittsburgh Declaration, 2009

3 European Commissioner for Financial Stability, Financial Services and Capital Markets Union, July 2016

4 IOSCO Statement on Priorities Regarding Data Gaps in the Asset Management Industry, June 2016

5 OECD/G20 Base Erosion and Profit Shifting Project, "Explanatory Statement: 2014 Deliverables", 2014

6 Greenwich Associates, Greenwich Report Q1 2015: European Fixed Income: E-Trading Growth Continues

7 BlackRock ETP Landscape, October 2016

8 House of Commons Work and Pensions Committee Automatic Enrolment Report 2015

9 BlackRock Investor Pulse Survey 2015

# Glossary

**IOSCO** – The International Organization of Securities Commissions is the international body that brings together the world's securities regulators. IOSCO develops, implements and promotes adherence to internationally recognized standards for securities regulation. It works closely with the G20 and the Financial Stability Board on the global regulatory reform agenda.

**FSB** – The Financial Stability Board is an international body that monitors and makes recommendations about the global financial system. It does so by coordinating national financial authorities and international standard-setting bodies. Reports to the G20.

**G20** – The Group of Twenty is a forum for international economic cooperation and decision-making. It comprises 19 countries plus the European Union, whose leaders meet annually.

**OECD** – The Organisation for Economic Co-operation and Development is a forum that brings governments together to share experiences and seek solutions to common problems. It works with 35 governments to understand economic, social and environmental change, predict future trends, and set international standards

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**European Commission** – The Commission is the EU's executive body, responsible for proposing and implementing EU laws, monitoring the treaties and the day-to-day running of the EU.

**European Parliament** – Members of the European Parliament (MEPs) are directly elected by voters in all Member States to represent people's interests with regard to EU law-making and to make sure other EU institutions are working democratically. It shares power over the EU budget and legislation with the Council of the European Union (commonly known as the European Council).

**European Council** – The EU's broad priorities are set by the European Council, which brings together national and EU-level leaders. It is led by its president and comprises national heads of state or government and the president of the Commission.

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**ESAs** – The ESAs are the three European Supervisory Authorities, that is, EIOPA, ESMA and the EBA.

**EIOPA** – The European Insurance and Occupational Pensions Authority is an independent advisory body to the European Commission, with the goal of supporting the stability of the financial system, transparency of markets and financial products as well as the protection of insurance policyholders, pension scheme members and beneficiaries.

**ESMA** – The European Securities and Markets Authority is an independent EU Authority that contributes to safeguarding the stability of the EU's financial system by enhancing the protection of investors and promoting stable and orderly financial markets.

**EBA** – The European Banking Authority is an independent EU Authority that seeks to ensure effective and consistent prudential regulation and supervision across the European banking sector. Its overall objectives are to maintain financial stability in the EU and to safeguard the integrity, efficiency and orderly functioning of the banking sector.

**Quantitative Easing** – QE is a form of monetary policy where a central bank introduces new money into the money supply through a series of financial assets purchases (asset purchase programmes), mainly government bonds. This process aims to directly increase private sector spending in the economy and return inflation to target

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**Regulations** – A Regulation is a pan-European legislative act that applies directly to the Member States.

**Directives** – A Directive is pan-European legislative act that Member States should implement in their national law

**Regulatory Technical Standards (RTS)** – detailed implementing measures that are drafted by the ESAs and adopted by the Commission by means of a Delegated Act

**Implementing Technical Standards (ITS)** – are adopted by means of an Implementing Act. These can be issued by the Commission, or by the ESAs for more technical issues.

**MiFID** – The Markets in Financial Instruments Directive governs the provision of investment services in financial instruments by banks and investment firms, as well as the operation of stock exchanges and alternative trading venues.

**UCITS** – Undertakings for Collective Investment in Transferable Securities (UCITS) are regulated investment funds that can be sold to the general public throughout the EU under a harmonised regime.

**AIFMD** – The Alternative Investment Fund Managers Directive is an EU regulatory framework for alternative investment fund managers (AIFMs), including managers of hedge funds, private equity firms and investment trusts, and covers the management, administration and marketing of alternative investment funds. Its focus is on regulating the AIFM rather than the AIF.

**Lisbon Treaty** – Signed in 2007, The Treaty of Lisbon takes the form of a series of amendments to the founding Treaties of the European Union, and included reforms to the EU institutions and decision-making process.

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