HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

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Financial Services: European aspects

By Timothy Edmonds

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Summary

The decision to leave the EU taken in June 2016 will have profound effects on the financial services sector in the UK. The economic impact will depend partly on the shape of the eventual outcome, although, for large companies, many might be forced to make decisions well in advance of negotiations starting, let alone being concluded.

The primary concern, across all financial institutions, is the future status of the country in terms of access to the EU financial markets. This is a concern for many parts of the economy, but for few can it be as critical as in financial services where the universal requirement to be authorised places a premium on the ability of firms to 'passporting' rights to other jurisdictions.

This Paper (first compiled pre-referendum) provides two things. First, it provides references to and EU initiatives and developments in the area of financial services or corporate legislative reforms. Second, it includes a list of past measures which are being implemented, or have recently been implemented, in the UK, by the UK's regulatory bodies.

The Paper cannot list every output or statement from the EU in this massive area of work, nor does it comment in great detail on the measures highlighted. Instead it aims to provide easy to use links to rapidly get more information on individual measures and simple background on what the measures are.

The European Commission (the Commission) has its own alternative 'scorecard' of measures arranged differently here. For bibliographical and archive material, readers are directed to another Library Paper *EU Bibliographies: Financial Services.*

The European Parliament Library has its own website which keeps track of where directives and other measures are in its Legislation Train.

1. Brexit

The decision of the 24 June 2016 to leave the EU has generated an enormous amount of uncertainty amidst the financial services industry, both in the UK, the EU and elsewhere.

Much existing financial services regulation is derived from the EU. Because of its size and influence, the UK has frequently led reform of financial services, particularly since the financial crisis, with retrospective checking for alignment with EU requirements. Where it has not been ahead of the EU it has played a significant part in the shaping of EU legislation. The Commissioner for Financial Stability, Financial Services and Capital Markets Union was, until he resigned on 25 June 2016, Johnathan Hill, the ex-Conservative Minister in the Coalition government.

Partly, given this background, the concern of the financial community and of UK regulators and the government is not what changes they want to make to existing financial legislation, it is likely that a significant amount of this legislation would remain post-withdrawal, though not necessarily in the same form or to the same extent.[1]

The issues

Although it is always well to remember that there can be conflicting interests in the 'City' – what suits a fund management firm may be of less a concern to an insurer, there is a pretty broad consensus on what the main worry is: access.

The primary concern, across all financial institutions, is the future status of the country in terms of access to the EU financial markets. This is a concern for many parts of the economy, but for few can it be as critical as in financial services where the universal requirement to be authorised places a premium on the ability of firms to 'passporting' rights to other jurisdictions.

Put simply, to function in EU countries, financial firms carrying out authorised activities have to be regulated. If they are headquartered and regulated in one Member State they can operate in and sell to, other Member States without getting authorisation from each one. Hence, given its attractive location, the size and liquidity of its markets, the depth of skills and infrastructure, London is a very attractive place to establish an HQ if one is, for example, a large American bank. With a UK authorisation an American/Japanese/Chinese bank can establish operations in all other member states.

If the UK is outside of the EU circle, it remains an attractive place to set up in, but, it could mean that an overseas firm might then need to choose between a centre with natural and historic advantages (London) and one with a regulatory/access advantage (EU). Authorisation of a big organisation is a complex and costly matter and there is no certainty that firms would simply carry on as before with a main operation in

1 Note See Phillip Hammond's comments on post Brexit legislation in evidence to the Treasury Committee Q30

London. EU authorities have made it clear that they will not countenance a situation whereby firms in the UK establish 'nominal' offices within the EU to gain authorisation and then carry on as before. EU subsidiaries had to be real working entities and not figureheads. Hence UK based organisations have to work out what functions they will want to genuinely transfer.

During the referendum campaign, it was mentioned that the potential for a negative impact was limited because the UK had various natural advantages including language and time zone. However, Scotland and N. Ireland share these advantages and are actively seeking ways to protect their positions. Scotland in particular has a very strong historical financial services industry which was thought, during the Scottish referendum, to be at risk if Scotland voted to leave the Union. The position would be quite different now. The Republic of Ireland also shares some of London's advantages and is actively seeking to attract financial services to Dublin.

A pro-market think tank, New Financial, set out the implications (from its pessimistic viewpoint) that City firms will generally be considering in the aftermath in a report - *Beyond Brexit: what happens next for European capital markets?* Published just after the Referendum. Many of its observations are still relevant 18 months later. They include:

> **2) First mover advantage:** Banks and asset management firms cannot afford to wait. They have to assume the worst case scenario of complete separation with no access to the single market and start the process of relocating legal entities, operations and staff immediately.
>
> **3) Relocation, relocation, relocation:** In order to future proof their business, banks, asset managers and other market participants will need to have a separately authorised subsidiary with a sufficient management presence inside the EU. Dublin, Frankfurt, Paris and other cities will be vying for that business.
>
> **4) An acrimonious divorce (and a protracted custody battle):** Most firms seem to be planning for an acrimonious divorce. While the divorce process itself may be reasonably swift, the separate negotiations to establish the terms of the future relationship between the UK and the EU will be slowed down by the competing domestic political imperatives in all 28 member states and could take years.
>
> […]
>
> **6) A regulatory backlash?:** Brexit could trigger a concerted regulatory backlash in the rest of the EU against elements of the single market and capital markets union that are seen to play to the UK's advantage, such as the location of euro-denominated clearing.
>
> **7) A loss of influence:** Whatever the outcome, the UK will lose influence over the future direction and nature of EU regulation that it may have to implement. The departure of Lord Hill will significantly change the tone of the future regulatory dialogue.
>
> **8) Equivalence vs divergence:** In order to retain access to the single market from outside the EU, the UK would have to retain an 'equivalent' regulatory framework. While it would be

> equivalent on day one, over time changes to EU legislation may lead to costly regulatory divergence.

The issue that it takes time (in years) for large organisations to complete authorisation and establish a new HQ abroad, and that this timetable appears to be at odds with the preference of some politicians and ministers for a more 'slowly, slowly' approach, has been highlighted in several commentaries. Few international offices seem prepared for a delay of indeterminate length before they begin to act. An article in the FT[2] estimates that there are about 70,000 overseas banks' employees in London

In terms of current issues, there remain many initiatives being discussed at EU level, notably the Capital Markets Union and a wide review programme of the workings of the roughly 40 measures passed but only now being implemented.[3] All of these will have an impact on the UK now and into the transition period.

The FCA is the main regulator of financial conduct in the United Kingdom. In the day after the referendum it said in a statement:

> Much financial regulation currently applicable in the UK derives from EU legislation. This regulation will remain applicable until any changes are made, which will be a matter for Government and Parliament.
>
> Firms must continue to abide by their obligations under UK law, including those derived from EU law and continue with implementation plans for legislation that is still to come into effect.

It reinforced this message in a statement in March 2018 following the Guidelines published by the European Union on the transition period:

> The implementation period is intended to operate from 29 March 2019 until the end of December 2020, during which time European Union law would remain applicable in the United Kingdom, in accordance with the withdrawal agreement. Firms and funds would continue to benefit from passporting between the UK and EEA during the implementation period. Obligations derived from EU law would continue to apply and firms must continue with implementation plans for EU legislation that is still to come into effect before the end of December 2020. Consumer rights and protections derived from EU law would also continue to apply.
>
> […]
>
> In light of the agreement on the terms of an implementation period and HM Government's commitment to providing for a Temporary Permission Regime as a backstop, firms and funds currently benefiting from an EU passport need not apply for authorisation at this stage.
>
> Temporary Permissions Regime for firms and funds passporting into the UK
>
> In December 2017, the Government announced its plan to legislate for a Temporary Permission Regime if necessary. This would enable relevant passporting firms and funds to undertake

2 Financial Times, 26 June 2016
3 Details in Library Paper: Financial Services European Aspects CBP7435

> new business that falls within the scope of their existing permissions, enable them to continue performing their contractual rights and obligations, manage existing business and mitigate risks associated with a sudden loss of permission.
>
> […]
>
> Firms and funds passporting into the EEA
>
> The implementation period would permit firms and funds to continue to benefit from passporting between the UK and EEA until the end of December 2020. UK firms and funds passporting into the EEA should discuss with their relevant EU regulator the implications of a transitional period for their contingency planning. The FCA will continue to cooperate closely with the home state regulators of EEA firms and the European Supervisory Authorities, and we stand ready to work with them to address any risks to consumer protection and financial stability.[4]

On the same day, the Bank of England set out its views on the medium-term future for financial firms in the UK:

> The foundation of the Bank of England's approach to preparations for EU withdrawal remains the presumption that there will continue to be a high degree of supervisory cooperation between the UK and the EU. This reflects the UK's financial system's role as both a national asset and a global public good, bringing shared risks as well as wide benefits.
>
> The Bank has made clear that it would be difficult, ahead of March 2019, for all financial institutions to have completed all of the necessary steps required to mitigate the risks to the provision of financial services in the EU and the UK.
>
> In light of the agreement at the EU Council, the Bank considers it reasonable for firms currently carrying on regulated activities in the UK by means of passporting rights, or the EU framework for central counterparties, to plan that they will be able to continue undertaking these activities during the implementation period in much the same way as now. **In letters published today, the Bank has made clear to relevant firms that they may plan on the assumption that UK authorisation or recognition will only be needed by the end of the implementation period**.[5]

This working assumption means that firms have, in theory more time before they have to make final decisions on location of staff and functions.

Current 'City' response (as at October 2017)

Transition

For many firms in the City, the period since the referendum has been spent looking at their options against the backdrop of considerable uncertainty, only lately has some of this uncertainty been removed.

As mentioned above, a moving staff and functions abroad requires planning and time and the current concern is that the UK is approaching the point at which the time needed to move is more than the distance between any decision about transition and actually leaving.

4 Financial Conduct Authority; Statement; 28 March 2018
5 Bank of England; Statement; 28 March 2018

According to the Chancellor, speaking to the Treasury Select Committee, "transition is a wasting asset":

> It is self-evident to me, and I think it will be to members of the Committee, that a transition arrangement is a wasting asset. It has a value today; it will still have a very high value at Christmas and early in the New Year. But as we move through 2018, its value to everybody will diminish significantly. Our European partners need to think very carefully about the need for speed in order to protect the potential value to all of us of having an interim period that protects our businesses and our citizens and allows investment and normal business activity, contracting and so on, to carry on.[6]

A Report commissioned by TheCityUK and published in May 2017, summarised the views of many institutions regarding how they saw the issue of getting from here to there:

- firms are seeking to secure an implementation period beyond the initial two-year period for negotiations. The general view across the financial services sector is that the two-year negotiation period will not be a sufficient time to negotiate the UK's exit arrangement, for the UK Government to redefine its ongoing relationship with the EU or for firms satisfactorily to effect any required reorganisation or restructuring. A longer implementation period will be of mutual benefit to both the EU and the UK;
- there are a number of areas where securing "grandfathering" rights is important for firms, not least so that firms can continue to service existing relationships with EU clients following Brexit;[7]

Moving

During 2017 there were many statements and articles saying that X bank is moving to set up operations in country Y. Commercial property dealings have been closely scrutinised as Z bank acquires extra floor space in Frankfurt or Dublin with options on more, as a way of trying to divine banks' intentions. There are far fewer concrete announcements of companies leaving, though the numbers are not insignificant. The Corporation of London keeps a tally of official announcements from City firms about their contingency arrangements. It currently puts 9,770 roles at risk, with Frankfurt receiving more business than any other EU financial centre.[8]

There are several surveys on the topic, some are summarised in this LSE Report

> The City of London may lose up to £18 billion in revenue and up to 30,000 jobs by leaving the single market (Oliver Wyman 2016). The analysis in this brief suggests that these estimates account for about 15 percent of financial sector revenue and 3 percent of employment in the City. Other estimates show similar magnitudes: £14–20 billion in revenue and 70,000 jobs lost (PWC 2016) or 83,000 jobs lost (EY 2017). According to these estimates, for the City of London the direct negative effect of

6 Evidence of Chancellor Philip Hammond to TSC Q23, 11 October 2017
7 *The Legal Background to Brexit on the UK financial services sector*, Freshfields, Bruckhaus Deringer; May 2017
8 TheCityUK press release . 21 September 2017.

> Brexit on the financial sector will be a 12–18 percent loss of revenue and a 7–8 percent drop in employment, clearly significant effects.[9]

Examples of actual announcements include:

- Bank JP Morgan Chase to relocate hundreds of its London employees to its offices in Dublin, Frankfurt and Luxembourg

> We are going to use the three banks we already have in Europe as the anchors for our operations," Daniel Pinto, the bank's head of corporate and investment banking, told Bloomberg. "We will have to move hundreds of people in the short term to be ready for Day One, when negotiations finish, and then we will look at the longer-term numbers.[10]

- Mitsubishi UFJ Financial Group, Japan's biggest bank, plans to choose Amsterdam as the new EU base for its investment banking operations after Brexit, sources told the FT. MUFG employs 2,100 people in London, but one person briefed on the plan told the paper the move would initially affect fewer than 100 jobs.
- Sumitomo Mitsui Financial Group plans to set up banking and securities units in Frankfurt to maintain business in the EU following Brexit. It is the third major Japanese lender to choose the German banking center as its new EU home base following similar decisions by Nomura Holdings and Daiwa Securities Group.

The Wyman Report, see above, which tends towards the pessimistic end of forecasts, can be found here.

A more optimistic stance is taken by David Blake in Returning the City to the Real Economy - a Golden post-Brexit Era beckons. Another, positive Report on what the future might look like long after Brexit, can be found in TheCityUK's A vision for a transformed, world-leading industry which sees a thriving financial services sector retaining its global lead though a number of interlinked strategies.

A Report published by the Centre For European Reform in March 2018: Brexit and the financial services industry, the story so far – says that:

> A leading consultancy firm in the financial sector says privately that major banks have individually spent over £150 million on Brexit plans and the cumulative costs will run into billions.[11]

And it agrees with CityUK and EY estimates of job losses:

> Accordingly, the effect on employment has been comparatively small, and largely reflects new jobs not being created. For the most part the new offices in the EU-27 are employing additional staff rather than taking staff from London and other parts of the UK. TheCityUK has estimated that the total effect so far is a net loss of around 10,000 jobs.
>
> The EY Brexit tracker monitors public statements of 222 of the UK's financial services companies. Thirty-one per cent have said publicly that they are considering moving or have confirmed that they are moving some operations or staff. EY estimates that

9 *The City of London after Brexit*, Simeon Djankov; LSE Discussion Paper 762
10 Bloomberg May 2017
11 Centre For European Reform in March 2018: Brexit and the financial services industry, the story so far

financial services firms have so far committed to move 1,500 jobs to the EU-27[12]

[12] Ibid

2. Recent European Initiatives

2.1 Retail financial services consultation

Timetable

Announcement: 17 December 2015

End date: 18 March 2016

Content

The consultation document can be found here.

The Green Paper sought views on how to improve choice, transparency and competition in retail financial services to the benefit of European consumers and on how to facilitate true cross-border supply of these services, so that financial firms can make the most of the economies of scale in a truly integrated EU market. It also looked at and discussed the impact of digitisation on retail financial services with a view to encouraging the growth of innovative solutions in this area in the EU. This resulted in a study published in July 2016.

A EuroBarometer Report 446 *Financial Products and Services* was published in July 2016. It found that although there was considerable depth to the European market for financial services:

> The national level results show that the majority of respondents in all countries have at least one financial product or service, although there are large discrepancies between Member States. Almost all respondents in Sweden (100%), the Netherlands and Denmark (both 99%) have at least one financial product or service, compared to 59% in Romania, 71% in Bulgaria and 79% in both Italy and Hungary. There are large differences between Member States for all financial products and services tested

There does not appear to be any specific measure taking this initiative forwards as at February 2017.

UK application

The Financial Conduct Authority (FCA) has three operational objectives of protecting consumers, ensuring market integrity, and promoting effective competition. Many of its 'Market Studies' and, to a degree its 'Thematic Reviews' are in effect examinations of how well either whole markets or individual market practices work for consumers. This would seem to be a process similar to that launched by the Commission.

2.2 European Deposit Insurance Scheme

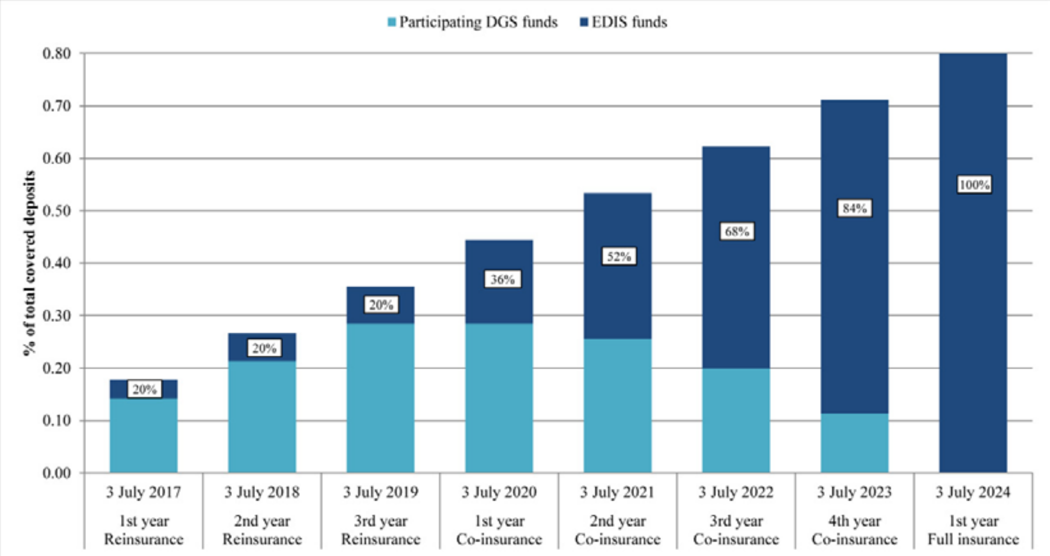
Timetable

Announcement: 14 November 2015

Content

The Commission announced a euro-area wide insurance scheme for bank deposits to further guarantee depositor protection in euro area banks. EU legislation already ensures that all deposits up to € 100,000 are protected in the case of a bank failure. However, at the moment this is done through countries' national deposit guarantee schemes (DGS), which are not backed by a common European scheme and may be vulnerable to large local shocks. The European Deposit Insurance Scheme (EDIS), by centralising deposit insurance, would provide stronger insurance cover for retail depositors.

The growing coverage of the scheme is illustrated in the diagram below:



Evolution of EDIS funds compared to the funds of a participating DGS (in case MS/DGS chooses to compensate)

UK application

The UK is not part of the euro-area and is unaffected (directly) by this proposal. It has to follow Directive 2014/49/EU which requires that:

> (20) The same coverage level should apply to all depositors regardless of whether a Member State's currency is the euro. Member States whose currency is not the euro should have the possibility to round off the amounts resulting from the conversion without compromising the equivalent protection of depositors.
>
> (21) On the one hand, the coverage level laid down in this Directive should not leave too great a proportion of deposits without protection in the interests both of consumer protection and of the stability of the financial system. On the other hand, the cost of funding DGSs should be taken into account. It is therefore reasonable to set the harmonised coverage level at EUR 100 000.[13]

The directive is implemented by the Deposit Guarantee Scheme (Amendment) Regulations 2015 (SI 2015/1456) which were debated in the House of Lords Secondary Legislation Scrutiny Committee – Sixth Report.

Since the €100,000 limit has to be periodically converted into sterling, the decline in the value of sterling since the EU Referendum, meant that the value of the guarantee was increased in sterling terms from £75,000 to £85,000 from 2017.

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13 Directive 2014/49/EU on deposit guarantee schemes

2.3 Regulatory framework consultation

Timetable

Announced 30 September 2015. Consultation ended 31 January 2016. The consultation is published here.

Content

The Commission looked for feedback, supported by actual experience and concrete examples, rather than simply opinion, on:

- 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 other unintended consequences.

The feedback received will contribute to a clearer understanding of the interaction of the individual rules and their combined impact, including potential overlaps, inconsistencies and gaps. It will help the Commission make informed decisions when it comes to the individual reviews that are set out in the existing legislation and provide a more solid evidence base to help decide if follow-up action is needed. The consultation will also help the Commission to develop the most appropriate calibrations for the upcoming level 1 and level 2 measures. Furthermore, the feedback will allow the Commission to contribute to the ongoing global debate on the coherence and consistency of financial rules.

An initial analysis of responses to the consultation were published in May 2016.

> Initial analysis of the responses points to three main areas that need particular attention. First, a number of respondents argued that certain parts of EU legislation are not sufficiently proportionate and called for rules that take greater account of companies' size, business models and risk profiles.
>
> Also, while a number of respondents emphasised the positive impact of EU rules on investor confidence and financial stability, others claimed that prudential rules – especially the Capital Requirements Regulation and Directive (CRR and CRD IV) - are reducing the amount of funding available for investment in the wider economy. The challenge is to make sure that the legislation in place continues to achieve its prudential requirements and at the same time support growth in Europe.
>
> There were also a number of complaints about the burden imposed by the complexity of the rules and the quantity and duplication of reporting requirements. Businesses complained that they are reporting and disclosing the same information in different ways to comply with different pieces of legislation and that the volume of information they are being asked to provide is not always proportionate to risk.[14]

In a separate but related piece of work, the Basel Committee on Banking Supervision has conducted a strategic review of those international reforms made to the prudential regulation of banks post crisis. The Basel Committee announced the results of its review in

[14] EU Commission press release 26 May 2016

December 2017 and endorsed a package of amendments to the Basel III framework that aim to finalise the post-crisis reforms. This agreement will now be subject to a Commission consultation and impact assessment to evaluate the consequences for the EU economy before it can be translated into EU law taking into account the results of the impact assessment.

UK application

The current body of UK financial regulation and rules has its origins in both UK initiatives and EU-originated requirements. There have been upwards of 40 directives introduced over a relatively short period of time and these have been incorporated into UK law either by primary or secondary legislation. The simple question – do all the pieces of this jigsaw fit? - is one that has been asked by several commentators.

For example, one of the impulses post-crisis has been to promote transparency as part of the regulatory culture. However, this is being introduced at the same time as an EU data protection directive which some commentators think travels in a different direction.

Much of the most accessible scrutiny work on EU financial service directives can be found in the reports of the House of Lords EU Financial Affairs Sub-Committee on Economic and Financial Affairs. This includes its Report *EU Financial Regulatory Framework*.[15] The Report highlighted what it saw as weaknesses in the post-crisis process, but nevertheless recognised real achievements too:

> We note that the most flawed of the legislative reforms were the result of political pressures to take prompt action, and/or to make the financial sector pay for the crisis. Prime cases include the Alternative Investment Fund Managers Directive (AIFMD), the bank remuneration provisions in the Capital Requirements Directive (CRD IV), and the contentious plans for a Financial Transaction Tax. Yet these are exceptions. We find that the bulk of the new regulatory framework was necessary and proportionate, and would have been implemented by the UK even if action had not been taken at EU level. We also find that it was highly desirable that regulation should be produced for the EU as a whole, both to strengthen the Single Market and to avoid regulatory arbitrage.
>
> That said, it was perhaps inevitable, given the amount of new legislation, its broad range and the speed of its introduction, that there would be a number of inconsistencies, rough edges and elements which, with the benefit of hindsight, were disproportionate or even misguided. Not enough consideration was given to the overall effect on the financial sector of such a huge programme of reform, or to ensure consistency with international regulation.
>
> We therefore welcome the commitment of the new European Commissioner for Financial Stability, Financial Services and Capital Markets Union, Lord Hill of Oareford, to review the cumulative effect of the various reforms. Such a review should include a thoroughgoing internal audit of the entire legislative framework

15 HL European Union Committee, *The post-crisis EU financial regulatory framework: do the pieces fit?* January 2015 HL 104 2014-15

> to date, with a view to making recommendations to remedy the key weaknesses that are identified.[16]

2.4 Capital Markets Union

Timetable

Announcement on 30 September 2015 that the Commission had adopted an action plan setting out 20 key measures to achieve a "single market for capital in Europe". By 2016 this had expanded to 33 measures addressing six key objectives. There was a mid-term review in June 2017.

Content

The Commission's Action Plan is focused on improving the ability of firms to raise finance on the capital markets across the EU area. There is a particular focus on small firm financing. The primary goals are:

> Stronger capital markets will complement Europe's strong tradition of bank financing, and will:
>
> - **Unlock more investment from the EU and the rest of the world:** Capital Markets Union will help to mobilise capital in Europe and channel it to all companies, including SMEs, infrastructure and long term sustainable projects that need it to expand and create jobs. It will provide households with better options to meet their retirement goals.
> - **Better connect financing to investment projects across the EU:** Member States with small markets and high growth potential have a lot to gain from a better channelling of capital and investment into their projects. Member States with more developed capital markets will benefit from greater cross-border investment and saving opportunities.
> - **Make the financial system more stable:** integrated financial and capital markets can help Member States, especially those inside the euro area, share the impact of shocks. By opening up a wider range of funding sources, it will help to share financial risks and mean that EU citizens and companies are less vulnerable to banking contractions. Furthermore, more developed equity markets, as opposed to increased indebtedness, allow for more investment over the long term.
> - **Deepen financial integration and increase competition:** more cross-border risk-sharing, deeper and more liquid markets and diversified sources of funding will deepen financial integration, lower costs and increase European competitiveness.
>
> Put simply, Capital Markets Union will strengthen the link between savings and growth. It will provide more options and better returns for savers and investors. It will offer businesses more choices of funding at different stages of their development[17]

[16] HL European Union Committee, *The post-crisis EU financial regulatory framework: do the pieces fit?* January 2015 HL 1034 2014-15

[17] EU Commission; *Action Plan on Building a Capital Markets Union*, COM(2015) 468

A convenient and accessible introduction to the plans can be found in the introductory remarks by the then Commissioner, Jonathan Hill, at the launch of the Capital Markets Union Action Plan (30 September 2015). A more visual guide can be found here.[18]

Progress in implementing the plan can be found in the Commission's regular Status Reports. The first of these can be found here. That document set out a number of work streams, in particular, attempts to restart the securitisation market which has stagnated since the financial crash; work on amendments to simplify the Prospectus Directive; and measures to stimulate more long-term investment in infrastructure projects by proposing to define infrastructure investment as an asset class under Solvency 2 (the 'omnibus' directive setting out capital requirements for insurance companies).

In early 2017 the Commission announced a consultation on the CMU programme to seek feedback on how/if the current programme can be updated and completed, building on the initiatives that the Commission has presented so far. The consultation is ahead of the 2017 mid-term review of the action plan.

In May 2016, the Commission produced a Report into the fast growing crowdfunding sector which it sees as having "the potential to be a key source of financing for SMEs over the long term".

Mid Term Review

The EU Commission undertook a mid-term review of the CMU. Its findings can be found here. Following the Review the following new initiatives were announced:

The CMU Mid-term review sets out nine new priority actions:

- strengthen the powers of European Securities and Markets Authority to promote the effectiveness of consistent supervision across the EU and beyond;
- deliver a more proportionate regulatory environment for SME listing on public markets;
- review the prudential treatment of investment firms;
- assess the case for an EU licensing and passporting framework for FinTech activities;
- present measures to support secondary markets for non-performing loans (NPLs) and explore legislative initiatives to strengthen the ability of secured creditors to recover value from secured loans to corporates and entrepreneurs;
- ensure follow-up to the recommendations of the High Level Expert Group on Sustainable Finance;
- facilitate the cross-border distribution and supervision of UCITS and alternative investment funds (AIFs);
- provide guidance on existing EU rules for the treatment of cross-border EU investments and an adequate framework for the amicable resolution of investment disputes; and

[18] Commissioner Hill resigned in June 2016 following the referendum result

- propose a comprehensive EU strategy to explore measures to support local and regional capital market development.

A list of actions taken since the 2017 Review includes *(last updated on 15 March 2018)*

- Financing for innovation, start-ups and non-listed companies
- Making it easier for companies to enter and raise capital on public markets
- Investing for long-term, infrastructure and sustainable investment
- Fostering retail investment
- Strengthening banking capacity to support the wider economy
- Facilitating cross-border investment
- Strengthening the capacity of EU capital markets

UK application

As one of the largest (if not the largest) capital markets in Europe the UK has a close interest in this project. The broad policy objectives will sit on highly technical and legal changes to all aspects of the investing and savings process. Included are revisions of insolvency and securities law as well as debate over the appropriate degree of consumer/investor protection. It also includes, or builds upon, existing legislative proposals such as the Prospectus Directive and Solvency 2.

The House of Lords European Union Committee's Sub-Committee on Economic and Financial Affairs produced a Report – *Capital Markets Union: a welcome start* – in March 2015. Its summary findings were broadly supportive of the aims and the way the Commission was attempting to reach those aims – "a mix of short-, medium- and long-term measures and a range of legislative and non-legislative tools" – but the Report cautions that:

> There is also a need for realism. Capital markets cannot and should not replace the banking sector, but should rather complement it as an alternative source of funding. The state of development of capital markets varies considerably between Member States, and the needs, cultures and priorities for Member States without developed markets will differ significantly from those such as the UK.
>
> Different tax treatments of financial instruments across Member States could impede the development of pan-European capital markets. The lack of harmonisation of securities law and insolvency law is another potential barrier. Yet agreement on reform of these areas will be difficult to secure. Any proposal for a system of pan-EU supervision is likely to be equally contentious.

And

> […]
>
> Nevertheless, Capital Markets Union presents a significant opportunity for the UK to promote the importance of capital markets, benefiting not just the UK economy but the EU as a whole. The UK must ensure that it is at the forefront of the

> debate as the Capital Markets Union agenda takes shape in the coming months.[19]

The main policy streams of the Capital Markets Union are set out and explained in the House of Lords Report. These are shown below with links to the relevant sections of the Report.

Improving and diversifying access to finance

Prospectus Directive

Developing securitisation as a source of funding

Private placement market

Credit information

Alternative financing

Taxation

Building a Capital Markets Union for consumers and investors

Introducing capital markets to savers and investors

Creating a diversified market

Consumer and investor protection

Additional barriers preventing investment

Stimulating long-term and infrastructure investment

Securitisation for investors

Securities law and insolvency law

[19] HL European Union Committee, *Capital Markets Union: a welcome start*, March 2015; HL 139 2014-15

3. Current EU financial or corporate measures

The list below shows EU financial services measures issued post-crisis. Links to content are largely (but not exclusively) either further Library or EU sources and are chosen such that readers can rapidly explore each measure further. The date at the top of each section indicates the date at which the material was added or updated for that measure. A similar and (likely) more up to date EU Parliament resource can be found here.

EU Post-Crisis Financial Regulation Measures
Solvency II
Single Euro Payments Area (SEPA)
European Market Infrastructure Regulation (EMIR)
Omnibus II
Alternative Dispute Resolution Directive / Online Dispute Resolution Regulation
Mortgage Credit Directive (CARRP)
Capital Requirements Directive IV / Regulation (CRD IV/CRR)
Transparency Directive II
Accounting Directive
Markets in Financial Instruments Directive II and Regulation (MiFID2/MiFIR)
Market Abuse Regulation (MAR)
Motor insurance directive
Credit Ratings Agencies Regulation
Audit Regulation & Directive
Venture Capital Funds and Social Entrepreneurship Funds Audit Regulation and Directive
Revised Data Protection Directive and Regulation
Central Securities Depositories Regulation CSDR)
Bank Recovery & Resolution Directive (BRRD)
Packaged Retail and Insurance-based Investment products (PRIIPS)
Insurance (Mediation (IMD II)) Distribution Directive
Undertakings for Collective Investment in Transferable Securities Directive (UCITS V)
Anti-Money Laundering Directive IV (AMLD IV)
Wire Transfer Regulation
Payment Accounts Directive (PAD)
Regulation on Interchange Fees
Long Term Investment Funds Regulation (ELTIF)
Payment Services Directive II (PSD II)
Regulation on Money Market Funds (MMF)
EU Benchmarks Regulation
Bank Structural Reform Regulation
Reporting and Transparency of Securities Financing Transactions Regulation
Institutions for Occupational Retirement Provisions Directive (IORP)
Revised Shareholders' Rights Directive
The Prospectus Directive

3.1 Single European Payments Area

Summary

The single euro payments area (SEPA) harmonises the way cashless euro payments are made across Europe. It allows European consumers, businesses and public administrations to make and receive money under the same basic conditions.

The SEPA project was launched by the European banking and payment industry represented by the European Payments Council (EPC). The payment services directive 2007/64/EC lays out the legal foundation for SEPA supplemented by the SEPA regulation (EU) No 260/2012.

The single euro payments area (SEPA) harmonises the way cashless euro payments are made across Europe. It allows European consumers, businesses and public administrations to make and receive the following types of transactions under the same basic conditions

- credit transfers
- direct debit payments
- card payments

This makes all cross-border electronic payments in euro as easy as domestic payments.

The SEPA project was launched by the European banking and payment industry represented by the European Payments Council (EPC). The EPC has designed the SEPA schemes for credit transfers and direct debits, and is developing a scheme for payment cards. It is also currently working on a new framework for mobile payments.

The European Central Bank (ECB) and the EU have also supported the SEPA process. The payment services directive 2007/64/EC lays out the legal foundation for SEPA.

The SEPA regulation (EU) No 260/2012 sets the rules and a deadline in February 2014 (later postponed to August 2014) for euro area countries to make credit transfers and direct debits in euro under the same conditions. It also contains arrangements for euro transfers in euros in countries outside of the euro area.

An FAQ document on SEPA can be founds from the EU Commission's website here.

3.2 Alternative Dispute Resolution Directive/ Online Dispute Resolution Regulation

(As at 5 February 2017)

This measure is a more general consumer protection measure rather than a financial services one.

The ADR Directive ensures that consumers have access to an ADR for resolving contractual disputes with traders. Access to ADR is ensured no matter what product or service they purchased (only disputes regarding health and higher education are excluded), whether the product or service was purchased online or offline and whether the trader is established in the consumer's Member State or in another one.

This Directive also established binding quality requirements for dispute resolution bodies offering ADR procedure to consumers. Member States' competent authorities, after their assessment, communicate to the European Commission the list of national dispute resolution bodies.

At the heart of the process is the Online Dispute Resolution platform (ODR platform).

The ODR platform is a web-based platform developed by the European Commission. It allows consumers to submit their disputes online and then transmits the disputes to the Member State's dispute resolution body nominated by the Member State. In the UK the body is the UK European Consumer Centre.

The ODR platform has been accessible to consumers and traders since 15 February 2016.

3.3 Mortgage Credit Directive

(As at February 2017)

Summary

The Mortgage Credit Directive 2014/17/EU was adopted on 4 February 2014. It aims to create a Union-wide mortgage credit market with a high level of consumer protection. Member States will have to transpose its provisions into their national law by March 2016.

A simple summary of the measure can be found in a Commission publication here.
A complete list of all relevant decisions and documentation can be found on the EU Commission website here.

The UK government decided to not apply the MCD to the buy to let market. New rules on arranging, lending and administering (consumer) buy-to-let mortgages are introduced by the Mortgage Credit Directive Order 2015. The main source for UK implementation material is the Financial Conduct Authority's (FCA) website here.

Another Library Paper describes the FCA's Mortgage Market Review.

Introduction

The Mortgage Credit Directive 2014/17/EU (MCD) on credit agreements for consumers relating to residential immovable property was adopted on 4 February 2014. This directive aims to create a Union-wide mortgage credit market with a high level of consumer protection. It applies to both secured credit and home loans. Member States will have to transpose its provisions into their national law by March 2016. Since mortgage activity in the UK already had a comprehensive regulatory framework the MCD impact will be less than in some other EU Member States. One of the biggest changes in the UK is that second charge mortgages move from the consumer credit regime into the full regulatory sphere. Hence providers now need to seek full authorisation.

The UK government decided not to apply the MCD to the buy to let market. New rules on arranging, lending and administering (consumer) buy-to-let mortgages are introduced by the Mortgage Credit Directive Order 2015.

EU action

The EU has had a very long standing ambition to extend the concept of a single market to financial services. This goes back to the Financial Services Action Plan first published in 1999. At its heart was the vision that European citizens would find it as easy to open a bank account in another Member State to their own, or to get a mortgage with a foreign lender as it would be with the building society in their own high street. Similar ambitions were expressed for capital markets and commercial markets.

A guide to the historical development of the single market in financial services and the free movement of capital within the EU can be found in chapter 1 of the Treasury's *Review of the Balance of Competences between the United Kingdom and the European Union*.

Mortgage credit was one market which the EU looked at and subsequently introduced proposals. The Directive covered issues such as:

- consumer information requirements including standardised calculations of interest rates,
- principle based rules and standards for the performance of services (e.g. conduct of business obligations, competence and knowledge requirements for staff),
- a consumer creditworthiness assessment obligation,
- provisions on early repayment,
- provisions on foreign currency loans,
- provisions on tying practices,
- some high-level principles (e.g. those covering financial education, property valuation and arrears and foreclosures); and
- a passport for credit intermediaries who meet the admission requirements in their home Member State.

The Mortgage Credit Directive (MCD) was adopted in 2013 and a simple summary of the measures can be found in an EU Commission publication here.

A complete list of all relevant decisions and documentation can be found on the EU Commission website here.

UK implementation

The UK has had a separate review of the mortgage market which is described in another Library Paper – Mortgage Market Review.

Like many EU financial service directives that need to be enacted in the UK, it is the FCA which is the responsible body.

The directive came into force in March 2016. The main source for implementation material is the FCA website here. One of the biggest changes is that second charge mortgages move out of the relatively lighter regulation of consumer credit and into the full regulatory sphere and hence providers now need to seek full authorisation.

Implementation of many directives is partly legislative (often secondary legislation) and part changes to the FCA rulebook (Handbook). In the case of the MCD the legislative measure is the *Mortgage Credit Directive Order 2015*.[20] Introducing the measure in the Delegated Legislation Committee, the then Minister, Andrea Leadsom said:

> Turning to the draft Mortgage Credit Directive Order 2015, the Government remain committed to ensuring that regulation of mortgages remains proportionate to the need for consumer protection. That is why we have asked the Committee also to consider that order, which will ensure that the UK implements the EU mortgage credit directive on time and with a limited impact on the UK mortgage market. The directive aims to enhance consumer

20 *The Mortgage Credit Directive Order 2015* SI 910/2015. This was amended later in the year by the *The Mortgage Credit Directive (Amendment) Order 2015* SI 1557/2015.

> protection and promote the creation of a more harmonised European mortgage market. However, the UK already has a strong regulatory framework, built up incrementally since 2004, which ensures strong consumer protections tailored to the specifics of the UK market. The MCD does not therefore offer many additional benefits to UK consumers beyond those already provided. However, it does have the potential to increase the burden on business, so the Government decided that the most appropriate course of action was to build on the existing UK regulatory regime, minimising the impact on the UK market, avoiding disruption and ensuring the gains made from improvements in regulation were not squandered unnecessarily. This approach means that the implementation of the MCD will be achieved primarily through adjustments to existing Financial Conduct Authority rules. However, there are areas where UK legislation has to be changed and this is the purpose of the draft order under consideration today.
>
> The order makes significant changes in two main areas. First, the regulation of second charge mortgages will move from the FCA's consumer credit regime into the mortgages regime. This is a long-standing policy commitment that has been well-received by industry and will ensure that lending secured on a borrower's home is regulated consistently.
>
> Secondly, the Government will use their exemption from the full directive requirements for buy-to-let lending, secured in negotiations, to put in place the minimum requirements needed to meet the UK's legal obligations. We remain unpersuaded of the case for the full conduct regulation of buy-to-let mortgage lending.
>
> The approach the Government have taken to implementing this directive will ensure compliance in a manner that minimises the impact on industry, retains the strengths of our regulatory framework for mortgages and ensures that consumers experience limited change as a result. By putting this legislation in place well in advance of the transposition date, we will give the industry the best possible chance of a smooth transition to the new regulatory framework.[21]

The consequences of exempting buy to let mortgages from the regime are set out in an FCA Consultation Paper and in a guide to buy to let implementation here. In short, the broking of buy-to-let mortgages will no longer be a regulated credit activity. However, advising on, arranging, lending and administering consumer buy-to-let (CBTL) mortgages will be subject to a legislative framework, as set out in the *Mortgage Credit Directive Order 2015*.

The Treasury's final impact assessment of the MCD can be found here.

[21] Delegated Legislation Committee 23 March 2015 c6

3.4 Market Abuse Regulation (MAR)

As at June 2016

Introduction

Market Abuse Regulation

A Market Abuse Directive which covered insider dealing and market manipulation in the securities industry was introduced in 2004. The 2007 financial crisis coincided with its implementation and caused a rethink of the original provisions. Modifications were agreed which form the Market Abuse Regulation (2014) and the Sanctions for Market Abuse Directive.

The two key issues dealt with are inside information or dealing and market manipulation, with appropriate criminal penalties attached to offences. The legislation must be enforced nationally by July 2016.

The EU Commission website on MAR can be found here. The FCA is the lead agency for this work in the UK its implementation Policy Statement was published in June 2016.

EU implementation

The Commission website on MAR can be found here. The regulation (596/2014) itself can be found here.

The directive on criminal sanctions for market abuse (2014/57/EU) can be found here.

A joint press release covering both noted:

> The Market Abuse Regulation ensures regulation keeps pace with market developments such as the growth of new trading platforms, over the counter (OTC) trading and new technology such as high frequency trading (HFT), strengthens the fight against market abuse across commodity and related derivative markets, explicitly bans the manipulation of benchmarks (such as LIBOR), reinforces the investigative and administrative sanctioning powers of regulators and ensures a single rulebook while reducing, where possible, the administrative burdens on SME issuers.
>
> The Directive on criminal sanctions for market abuse (Market Abuse Directive) complements the Market Abuse Regulation by requiring all Member States to provide for harmonised criminal offences of insider dealing and market manipulation, and to impose maximum criminal penalties of not less than 4 and 2 years imprisonment for the most serious market abuse offences. Member States will have to make sure that such behaviour, including the manipulation of benchmarks, is a criminal offence, punishable with effective sanctions everywhere in Europe.[22]

UK implementation

The Financial Conduct Authority (FCA) is the lead regulator responsible for implementing MAR in the UK. The new rules will apply to the UK from 3 July 2016.

The new requirements on UK firms are set out on the FCA's website:

> **Inside information and disclosure:** the definition of inside information has been widened to capture inside information for spot commodity contracts. The obligation to disclose inside

[22] EU Press release 12 June 2014

information has been extended to some Emissions Allowance Market Participants (EAMPs). Issuers and EAMPs must notify the regulator after delaying disclosure of inside information, and financial institutions must seek consent from the regulator prior to delaying disclosure due to financial stability concerns.

Insider dealing and unlawful disclosure: it is clarified that the use of inside information to amend or cancel an order shall be considered to be insider dealing. It is also clarified that recommending or inducing another person to transact on the basis of inside information amounts to unlawful disclosure of inside information.

Market manipulation: the manipulation offence has been extended to capture attempted manipulation. Benchmarks, and in some situations spot commodities, are now in scope of the manipulation offence. Examples of behaviours and activities that shall be considered as market manipulation are set out e.g. acting in collaboration to secure a dominant position over the supply or demand of a financial instrument, and certain algorithmic trading strategies which disrupt the functioning of a trading venue.

Market soundings: introduces a framework for persons to make legitimate disclosures of inside information in the course of market soundings.

Buy-back programmes and stabilisation measures: makes revisions to the existing framework for conducting buy-back programmes and stabilisation measures.

Accepted market practices (AMPs): continues to permit regulators to establish an accepted market practice which is subject to certain criteria and conditions.

Insider lists: places an obligation on issuers and EAMPs to draw-up and maintain a list of all those persons working for them that have access to inside information.

Suspicious transaction and order reports (STORs): extends the existing obligation on suspicious transactions, to include suspicious orders too. Trading venues are also caught by the obligation to submit STORs.

Managers' transactions: persons discharging managerial responsibilities within issuers (PDMRs), and persons closely associated with them, must notify the issuer and the regulator of relevant personal transactions they undertake in the issuer's financial instruments. The issuer in turn must make that information public within three business days.

Investment recommendations: requires persons producing or disseminating investment recommendations to present information objectively, and to disclose any conflicts of interest.

Whistleblowing: places requirements on regulators and firms to be able to receive whistleblowing notifications.[23]

The FCA produced a policy statement on implementation in June 2016.

A briefing on the application of both the regulation and the directive in the UK by solicitors Freshfields Bruckhaus and Deringer can be found here.

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23 FCA website

3.5 Motor Insurance Directive

(As at March 2017)

On 30 May 2002 agreement was reached between the national insurers' bureaux of the Member States of the European Economic Area and other Associate States, under which each national bureau guaranteed the settlement of claims, in accordance with the provisions of national law on compulsory insurance, in respect of accidents occurring in its territory, caused by vehicles normally based in the territory of another Member State.

Information on the directive from the EU Commission can be found here. In short:

The directive

- obliges all motor vehicles in the EU to be covered by compulsory third party insurance
- abolishes border checks on insurance, so that vehicles can be driven as easily between EU countries as within one country
- specifies minimum third-party liability insurance cover in EU countries
- specifies exempt persons and authorities responsible for compensation (pdf 129kb)
- introduces a mechanism to compensate local victims of accidents caused by vehicles from another EU country
- requires claims about accidents in an EU country other than the victim's country of residence to be settled quickly (so-called visiting victims)
- entitles policy holders to request a statement of any claims involving their vehicle, which were covered by their insurance contract, over the last 5 years

the directive has had to be adapted following a 2014 decision by the European Court about the use and insurance of vehicles on private property. An EU document explains:

> On 4 September 2014, the Court of Justice of the European Union ruled on a question by the Slovenian Supreme Court to interpret the scope of this Directive in the context of proceedings that concerned an accident on a private property caused by a tractor (C-162/13 Vnuk), in particular whether the obligation of third party liability cover extended to private properties. The Court ruled that the concept of 'use of vehicles' covers any use of a motor vehicle that is consistent with the normal function of that vehicle. It was implied in the ruling that there was no difference between private or public properties as regards the obligation of cover.
>
> The effect of the ruling is that vehicles used in certain locations and/or certain activities by vehicles which may not have been initially understood to be regulated under the Directive by some Member States are covered by the obligation of insurance cover in the Directive, and that also some non-road-traffic motoring

activities must be covered by third party liability insurance. Consequently, accidents that are result of purely agricultural, construction, industrial, motor sports or fairground activities, in Member States which exempt these vehicles from the requirement to hold third party liability coverage, may be compensated from motor third party liability policies.

3.6 Audit Regulation and Directive

(As at February 2017)

Introduction

Audit scandals in the USA and Europe and the financial crash in 2008 led to calls for greater scrutiny of the audit profession. The belief was that the accounts of several financial institutions had been given unjustified clean audit reports and so potentially misled investors and regulators, undermining confidence in the financial system as a whole and affecting the efficient allocation of financial capital. Many investors asked how a bank could become insolvent barely six months after audited accounts had indicated that it was financially sound.

The resulting EU legislative proposals consists of two main elements:

- First, to widen the scope of the existing 2006 directive on audits to cover additional entities.
- Second, the changes increase the scope of the requirements of the directive, while moving most of the requirements into the new regulation.

The Government have indicated that they propose to go beyond minimum implementation by introducing additional requirements to facilitate a more flexible implementation and to ensure consistency with the domestic application of the 2006 directive.

One of the main extensions of the regulation is that in the future all Public Interest Entities (PIEs) will be required to have an audit committee whether listed or not. Broadening the scope of businesses covered by the existing requirements will impose costs on newly included businesses, for example, unlisted PIEs will have to establish audit committees.

Apart from increasing the range of businesses covered by the 2006 directive and the new regulation, all businesses that fall within the scope of the proposals will have to adjust to the changed statutory audit requirements.[24]

EU Response

Information about the EU response including Directive 2014/56/EU and Regulation (EU) No 537/2014 can be found here.

The current rules consist of

- an amending directive (Directive 2014/56/EU) that sets out the framework for all statutory audits, strengthens public oversight of the audit profession and improves cooperation between competent authorities in the EU

24 Notes taken from Regulatory Policy Committee *UK implementation of the EU Directive on statutory audits of annual accounts and consolidated accounts, and of the EU Regulation on specific requirements regarding statutory audit of public interest entities 2014*

- a regulation (Regulation No 537/2014) that specifies requirements for statutory audits of public interest entities (PIEs), such as listed companies, banks and insurance undertakings.

One of the key parts of the regulation is the requirement to rotate auditors so that the same company cannot be audited by the same auditor forever. Article 17 of the regulation states that "neither the initial engagement of a particular statutory auditor or audit firm, nor this in combination with any renewed engagements therewith shall exceed a maximum duration of 10 years." There is flexibility over the time limits and the UK intends to allow auditors to work with the same company for up to 20 years.[25]

UK Response

The main source of information about the UK implementation can be found here. There was a major consultation exercise involving the Financial Reporting Council (FRC), BIS, FCA and the Prudential Regulation Authority (PRA). The initial consultation can be found here and the government response to the consultation here.

The main changes will be:

> The Regulation introduces a framework for mandatory rotation and retendering of audit engagements. It also introduces significant new controls on the provision of non-audit services by statutory auditors to their audit clients.
>
> The Regulation only applies to the audits of 'Public Interest Entities' (PIEs). The definition of a PIE will be restricted to entities with securities admitted to trading on a regulated market, banks, building societies, and insurers.
>
> All PIEs will be required to put their audit out to tender at least every 10 years and change their auditor at least every 20 years.
>
> The Directive requires all Member States to identify a Competent Authority for the regulation of statutory audits. This will be the Financial Reporting Council (FRC) in the UK. The FRC will be required to delegate tasks as much as possible to Recognised Supervisory Bodies (RSBs). The FRC will continue to be the standard setting body for auditors, and will have to conduct audit inspections, investigations and disciplinary cases in relation to PIEs.
>
> **Limited Liability Partnerships**
>
> Our final Impact Assessment considers applying the amended Directive framework to audits of LLPs. This would continue the current approach of making LLPs subject to the same audit regulatory framework that applies to companies and other business entities, noting that those LLPs with listed debt or that offer banking or insurance services will have to be covered by the Directive and the Regulation anyway.
>
> Our Impact Assessment indicates there would no significant additional costs resulting from applying the updated framework to LLPs, so we propose that this should be undertaken on a longer timeframe to avoid distracting from delivery of the necessary changes in the light of the nearing implementation deadline.[26]

[25] Accountancy; February 2016; pp68-9
[26] BIS; *Auditor Regulation*; May 2016

The changes took effect in June 2016. A helpful summary of the practical implications can be found on the Institute for Chartered Accountants website here.

3.7 Bank Recovery and Resolution Directive (BRRD)

(As at March 2016)

UK Response

One of the first discoveries of the financial crisis was that existing insolvency procedures were ill suited to bank rescues. In effect there was no effective legal mechanism, to rescue banks. By contrast, if a car maker goes bust the administrator/liquidator quickly locks the gates and sets about realising the assets – selling the finished cars, the capital equipment, the factory building, calling in the debts etc. This is unfeasible for a bank. A bank's assets are its loans and mortgages and it cannot simply demand that its customers repay these loans in short order, or take millions of people to court if they fail to do so.

This had been known for some time previous, but pressures on parliamentary time and what appeared to be a remote chance of bank failures meant that legislation to change this had not been a priority.

So when the crash came, legislation had to be passed fairly quickly. In the UK, what are called recovery and resolution (R&R) provisions were first set out in the *Banking Act 2009*.

The provisions were discussed fully in a Treasury Committee Report, *Banking Reform*.[27]

For more information on the UK implementation of the directive (see below) see the Prudential Regulation Authority's list of documents setting out discussion and implementation of BRRD which can be found on the Bank's website.

EU Response

The main EU Commission's explanatory notes are here. A flavour of the proposals is the Commission's FAQ page here. It describes the key elements of any R&R regime:

> **Preparation and prevention**: banks and resolution authorities are required to draw up recovery and resolution plans on how to deal with situations which might lead to financial stress or the failure of a bank. If authorities identify obstacles to resolvability during the course of this planning process, they can require a bank to take appropriate measures, including changes to corporate and legal structures, to ensure that it can be resolved with the available tools in a way that does not threaten financial stability and does not involve costs to taxpayers.
>
> **Early intervention**: Bank supervisors are accorded an expanded set of powers to enable them to intervene if an institution faces financial distress (e.g. when a bank is in breach of, or is about to breach, regulatory capital requirements), but before the problems become critical and its financial situation deteriorates irreparably. These powers will include the ability to dismiss the management

[27] Treasury Committee; Banking Reform; 17th Report 2007/8; HC1008

> and appoint a temporary administrator, as well as convening a meeting of shareholders to adopt urgent reforms and requiring the bank to draw up a plan for the restructuring of debt with its creditors.
>
> **Resolution**: The objective of resolution is to minimise the extent to which the cost of a bank failure is borne by the State and its taxpayers. To this end, should the bank in distress continue to fail, the BRRD provides resolution authorities with a credible set of resolution tools. These include the power to sell or merge the business with another bank, to set up a temporary bridge bank to operate critical functions, to separate good assets from bad ones and to convert to shares or write down the debt of failing banks (bail–in). These tools will ensure that any critical functions are preserved without the need to bail out the bank, and that shareholders and creditors of the bank under resolution bear an appropriate part of the losses. They should also prevent the precipitous loss of value in a failing bank associated with bankruptcy, for example by quickly recapitalizing it and allowing it to be restructured.
>
> **Cooperation and coordination**: The BRRD also provides a framework to improve cooperation between national authorities so that, should a cross-border banking group fail, national authorities will be able to coordinate resolution measures to protect financial stability in all affected Member States and achieve the most effective outcome for the group as a whole.[28]

With respect to the UK and other Member States it says:

> How does the EU bank recovery and resolution framework square with the resolution regime adopted in some Member States?
>
> Many Member States already have in place or have recently introduced mechanisms at national level to resolve failing banks (e.g. the UK, Germany, Denmark, Ireland, Greece, Portugal, the Netherlands, France and Italy). These regimes pursue the same objectives and are generally compatible with the framework set out under the BRRD.
>
> The Directive sets out a minimum harmonised set of tools and powers, so that Member States would be able to introduce additional tools at national level to deal with crises, as long as they are compatible with the resolution objectives and principles set out in the BRRD, as well as State aid rules provided for at EU level. For Member States participating in the Banking Union, the Single Resolution Mechanism fully harmonises the range of available tools.

28 EU Commission; Bank Recovery and Resolutions FAQs

3.8 Packaged Retail and Insurance-based Investment Products Regulation (PRIIPS)

(As at March 2016)

Summary

EU Commission's proposal of 2012 was a reaction to the perceived loss of confidence amongst consumers for financial products, post financial crisis.

At the heart of the Regulation is a requirement, for retail products, of a key information document (KID) which gives key facts to investors in a clear and understandable manner.

The regulation came into force 31 December 2016

There will be a forthcoming FCA consultation on the required Handbook rule changes.

Introduction

The Commission's original proposal was published in 2012. It was a reaction to the perceived loss of confidence amongst consumers for financial products post financial crisis. The Commission's initial press release outlined the issue it was trying to address:

> The financial crisis has become a crisis of consumer confidence. Lack of transparency, low awareness of risks, and poor handling of conflicts of interest have meant that consumers across the EU have been repeatedly sold investment and insurance products that were not right for them. Consumers have had their faith in the financial sector shaken. In addition, existing legislation has not developed fast enough to reflect the growing complexity of financial services.
>
> Only by taking steps to tackle these shortcomings can low consumer confidence be tackled, laying strong foundations for growth in the EU. Strong, well-regulated retail markets that place the best interests of consumers at their heart are necessary for consumer confidence and economic growth in the medium and longer term. That is why today, the Commission has presented a legislative package that raises standards and removes loopholes for the benefit of consumers. Specifically, the package proposes new, consumer-friendly standards for information about investments, raises standards for advice, and tightens certain rules on investment funds to ensure their safety.[29]

At the heart of the regulation for PRIIPs sales is a key information document (KID) – a simple document which gives key facts to investors in a clear and understandable manner. It covers not only collective investment schemes but also other 'packaged' investment products offered by banks or insurance companies.

EU Response

The main EU Commission's explanatory notes are here. Regulation (EU) No 1286/2014 was published on 26 November 2014. The text can be found here.

On 11 November 2015 the Joint Committee of the European Supervisory Authorities published a joint Consultation Paper in relation

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29 EU Commission Press Release 3 July 2012

to draft regulatory technical standards with regard to PRIIPs Key Information Documents (the "draft RTS"). The Consultation ended on 29 January 2016. The Regulation has been adopted and came into force on 31 December 2016.

The draft regulatory technical standards – which underpin the regulation were published by the European Supervisory Authorities (ESA) in November 2015.[30]

UK Response

The then Financial Services Authority and the FCA have been responsible for implementation in the UK. The FCA website page here has a considerable amount of information about both the regulation and its implementation in the UK.

The FCA states:

> We expect the Regulation to apply to:
>
> - retail investment product providers
> - life companies
> - discretionary investment management firms
> - firms providing services in relation to insurance-based investments fund managers
> - stockbrokers and other firms that provide advice to retail clients on funds, structured products and derivatives
> - financial advisers
> - firms operating retail distribution platforms[31]

At the heart of the regulation is the KID. The FCA outline the key features of KIDs.

> Each KID will need to contain the following information, presented in a pre-determined sequence of sections. The sections are:
>
> - What is this product?
> - What are the risks and what could I get in return?
> - What happens if [name of the PRIIP manufacturer] is unable to pay out?
> - What are the costs?
> - How long should I hold it and can I take money out early?
> - How can I complain?
> - Other relevant information[32]

The regulation will be made by changes to the FCA Handbook. A consultation will follow.

30 Joint Committee of the European Supervisory Authorities; November 2015

31 FCA website

32 FCA website

3.9 Insurance (Mediation) Distribution Directive

(As at March 2017)

The sale of insurance products in the EU is regulated by the insurance mediation directive (IMD). The IMD only applies to brokers and other insurance intermediaries. It obliges them to register in their home country and meet certain minimum requirements and be regulated.

In 2016 the European Commission adopted new rules to widen the IMD's scope to all sellers of insurance products, including insurance companies that sell directly to consumers. They will apply from 23 February 2018.

Under the new framework, known as the insurance distribution directive (IDD), consumers and retail investors buying insurance products will benefit from

- greater transparency in the price and costs of insurance products
- a simple, standardised insurance product information document (IPID) providing clearer information on non-life insurance products, so that consumers can make more informed decisions
- where insurance products are offered in a package with another product or service, for example when a new car is sold together with motor insurance, consumers will have the choice to buy the main product or service without the insurance policy
- rules on transparency and business conduct to help consumers avoid buying products that do not meet their needs

Links to more information about insurance directives can be found on the EU Commission's website here.

UK Implementation

On 6 March 2017 the Financial Conduct Authority (FCA) published the first of its two consultation papers on the implementation of the IDD: CP17/7: Insurance Distribution Directive Implementation

The consultation paper covers the FCA's proposals for the application of the directive, which include the following areas:

- professional and organisational requirements
- complaints handling and out-of-court redress
- professional indemnity insurance (PII)
- changes to conduct of business rules (for non-investment insurance contracts)
- the regulatory regime for ancillary insurance intermediaries

The IDD will apply more broadly than the IMD and bring consumer protection rules in line with those in other financial markets. The UK is required to comply by 23 February 2018.

3.10 Anti-Money Laundering Directive IV (AMLD IV)

(As at March 2016)

Introduction

Money laundering describes the procedures used to make money which has been acquired from criminal activity appear to have been lawfully acquired. These procedures are typically highly complex and by design hard to trace. Funds, whether generated through organised crime, terrorism or drug trafficking, are placed within the mainstream economy or financial sector and the source and origin of the funds is progressively concealed with each transaction.

As the chapter heading suggests this is the latest in a long line of anti-money laundering measures proposed by the EU. The history of previous measures has been an expansion in the scope of powers, and responsibilities of, financial institutions to act as 'policemen'; a greater range of institutions brought within its net and a widening of the targets they aim at from simple criminality to terrorism.

At its heart, those subject to the law must:

- identify and verify the identity of their customers and of the beneficial owners of their customers (for example, by ascertaining the identity of the natural person who ultimately owns or controls a company), and to monitor the transactions of and the business relationship with the customers;
- report suspicions of money laundering or terrorist financing to the public authorities - usually, the financial intelligence unit; and
- take supporting measures, such as ensuring the proper training of personnel and the establishment of appropriate internal preventive policies and procedures.

AMLD IV was originally been proposed in February 2013. It consists of two legal instruments:

- A directive on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing;
- A regulation on information accompanying transfers of funds to secure - "due traceability" - of these transfers.

It was agreed in the EU Council in June 2014 and by the European Parliament in December 2014. Terrorist activity in Copenhagen, Paris and Brussels in 2014/15 gave further impetus to the review.

EU Response

A detailed justification and assessment of the need for new legislation was published by the Commission here. Proposing further reforms the Commission stated that:

> The changes agreed at international level do not represent a fundamental re-calibration of the anti-money laundering rules,

but rather a refinement of the rules. Among the most important changes are:

- The reinforcement of the "Risk-Based Approach", applied both by obliged entities and supervisors, coupled with a need to assess AML/CFT risks facing jurisdictions.
- Designation of "Tax Crimes" as a new "predicate offence" (i.e. so that money laundering includes cases where the proceeds of tax evasion were involved). Introduction of a new requirement for all cross-border wire transfers to include beneficiary information and to expansion of the scope to certain e-money and mobile telephony payment products.
- Further clarification and guidance in areas such as customer due diligence, beneficial owner and Politically Exposed Persons (PEPs).

Additionally, from an EU perspective, our own review process has indicated a need to address a number of areas in the EU Directive, for example:

- How to share AML supervisory responsibility between home and host competent authorities. In the wake of the transposition of the Payment Services Directive, concerns have been raised by a number of Member States, about potential gaps in the AML framework caused by payment institutions operating across borders via networks of retail agents.
- A tightening of the EU's Simplified Due Diligence regime, given that it has been criticised by the FATF as representing too broad a waiver from applying the Customer Due Diligence for certain bodies and products.
- Clarification with respect to EU data protection rules, in particular regarding the ability to transfer information to different parts of an international group (including operating in third countries) for anti-money laundering purposes.
- Enhancing transparency of beneficial ownership information and clarification of the existing 25% ownership threshold
- Enhancement of cooperation and information sharing between EU FIUs – entailing integration of Council Decision 2000/642/JHA into the EU Directive.[33]

There is now a directive and a regulation. The text of the Directive (EU COM/2013/045) can be found here. The text of the Regulation (EU COM/2013/044) can be found here.

In April 2016 the Commission published the roadmap for the targeted revision of the 4th Anti-Money Laundering Directive (AMLD IV). The revision is part of a list of actions announced in the Commission's action plan on strengthening the fight against terrorism, published on 2 February 2016. The plan's objective is to step up the EU's fight against terrorism and to strengthen its efforts to combat terrorist financing.

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33 EU Commission press release

Although the Directive is still being transposed into domestic legislation of each Member State (with the deadline of 26 June 2017), the Commission has already decided to amend the Directive in five specific areas:

- enhanced due diligence measures/counter-measures with regard to high-risk third countries;
- virtual currency exchange platforms;
- prepaid instruments;
- the access of Financial Intelligence Units (FIUs) to – and exchange of – information to strengthen FIU powers and cooperation; and
- the access of FIUs to centralised bank and payment account registers or electronic data retrieval systems.

A comprehensive EU FAQ page can be found here. The directive came into force in June 2015. Member States have two years to implement it.

UK Response

More detailed information about money laundering in the UK can be found in another Library Paper (*Money Laundering Law SN 2592*).

During 2015 there was a significant reassessment of the UK's anti money laundering (AML) approach, which was wider than the AMLD IV. The first strand was the *High End Money Laundering Strategy and Action Plan* published by the National Crime Agency in December 2014.

The second was a follow-on Report published jointly between the Treasury and the Home Office in October 2015 - *UK national risk assessment of money laundering and terrorist financing.*[34]

High End Money Laundering Strategy

High end money laundering relates mainly to major frauds and overseas corruption work, where the raw material of the crime is electronic and cash is only used further down the laundering process to disguise audit trails or extract profits. In this respect, it can be distinguished from the laundering of street cash generated by the activities of organised criminal groups.

It will comprise the following streams of work will begin:

i) Improving the intelligence picture and cross-agency intelligence flows to better direct the targeting of our multi-agency investigation capability

ii) Improving relationships and levels of co-operation with the private sector and relevant professional/regulatory bodies

[34] HM Treasury, Home Office; *UK national risk assessment of money laundering and terrorist financing*;: October 2015

iii) Developing a multi-agency taskforce approach and delivering quality law enforcement interventions

iv) Upskilling financial investigators to enable them to undertake complex and high end money laundering casework[35]

Under the heading of improved intelligence there will be a new unit the Money Laundering & Corruption Threat Desk within the National Crime Agency's Intelligence Hub. This will be a dedicated team of analysts who draw together intelligence picture around this kind of money laundering.

It will work closely with cross-sector experts such as the new Centre for Financial Crime and Security Studies, established by the Royal United Services Institute (RUSI) in December 2014.[36]

UK National Risk Assessment

The National Risk Assessment's (NRA) 'Key Findings' include:

- The size and complexity of the UK financial sector mean it is more exposed to criminality than financial sectors in many other countries
- UK law enforcement agencies want to know more about the role of the financial and professional services sectors (banks, legal, accountancy and trust and company service providers) in money laundering. They judge the threat in these sectors to be significant, and are still establishing the strength of understanding needed in this area.
- The effectiveness of the supervisory regime in the UK is inconsistent.
- The law enforcement response to money laundering has been weak for an extended period of time. It has not been a priority for most local police forces (although the metropolitan forces appear to provide a more effective response).
- Supervisors and private sector representatives consulted in the course of producing the NRA voiced repeated criticism of the SARs (Suspicious Activity Reports) regime. In December 2014 the government committed to reviewing the regime.[37]

There has only been limited implementation moves in the UK so far. Part 7 of the *Small Business, Enterprise and Employment Act 2015* introduced provisions which requires companies to set up registers to record the ultimate 'beneficial' owners of businesses. The registers will be accessible by 'authorities' within each country and to 'obliged entities' such as banks, doing due diligence into their customers. This requirement is derived from Chapter 3 of AMLD IV:

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35 National Crime Agency *High End Money Laundering Strategy and Action Plan*;
36 National Crime Agency *High End Money Laundering Strategy and Action Plan*
37 HM Treasury, Home Office; *UK national risk assessment of money laundering and terrorist financing*, October 2015

> Article 29
>
> 1.Member States shall ensure that corporate or legal entities established within their territory obtain and hold adequate, accurate and current information on their beneficial ownership.
>
> 2.Member States shall ensure that the information referred to in paragraph 1 of this Article can be accessed in a timely manner by competent authorities and by obliged entities.[38]

More information on the measure can be found in Library papers on the Bill.

[38] AMLD IV

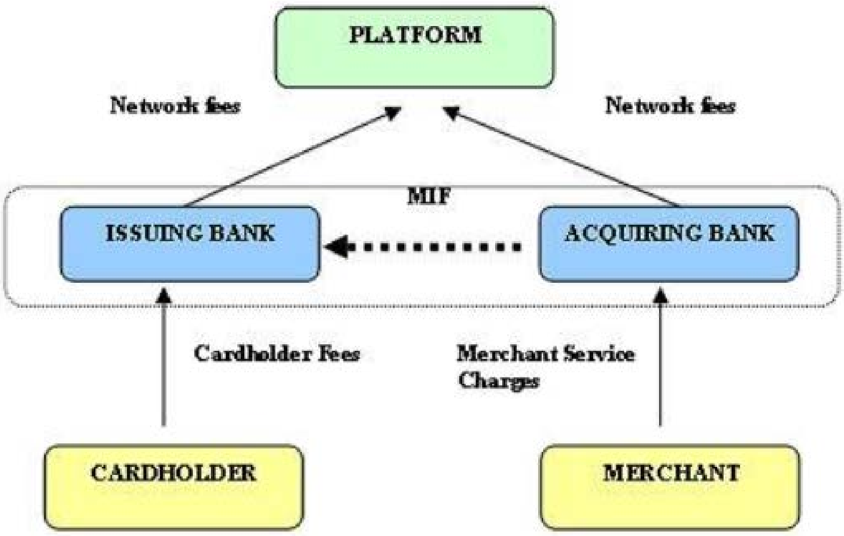
3.11 Regulation on Interchange fees

[As at March 2016]

The use of credit cards for payment purposes involves several agents. The consumer, the merchant or shop and the issuer of the card which is often a bank and the banks of both merchant and customer.

The card issuer provides the financial liquidity and the technical expertise without which credit cards could not work. This is not costless but the way in which the costs are charged for and who actually pays them are unclear.

The card issuer (bank) typically charges a fee for each transaction, but since this varies according to the size of the merchant, it is not clear how such fees are arrived at. The merchant pays the fee but in a completely non transparent way can pass on the costs of the fee by way of higher prices. Merchants are unable to advertise discounted prices if people 'pay cash', so the entire charging cycle is shrouded in mystery. Some organisations, particularly those on the internet make charges for credit card (as opposed to debit card) use. There is no way for consumers to tell if these charges are accurate or not. An EU Commission document illustrates the various payment flows which take place.



EU Response

The challenge to the system described above came in the form of a case in September 2014 at the European Court of Justice. The Master card Judgement ruled that such interchange fees are a violation of EU antitrust rules.

This set in train the start of proposals for a Regulation which would cap the level of fees which the banks could charge. An EU press release issued when the Regulation had been agreed by the Parliament stated:

> As a general rule, the Regulation will cap interchange fees at 0.2% of the transaction value for consumer debit cards and at 0.3% for consumer credit cards. For consumer debit cards, it also gives flexibility to Member States to define lower percentage caps and impose maximum fee amounts. Besides capping interchange fees, the Regulation also increases transparency on fees and will enhance competition for payment card schemes and banks by e.g. addressing licensing issues and other conditions that have restricted the freedom of choice of retailers.
>
> Furthermore, the Regulation removes major obstacles to technological innovation in payment options. Technologies that allow consumers to pay with their debit or credit cards online or using their mobile phones (with apps, fingerprints, contactless "swipes", etc.), are readily available. However, uncertainty on the rules regarding interchange fees has been one of the factors holding up the use of these technologies.[39]

The Regulation can be found here. It came into force in December 2015. More background information can be found on the Commission's press release.

UK Response

The Regulation will be implemented in the UK by the Payment Systems Regulator. Two sets of guidance have been issued. One in March 2016 focussed on the fees, and one in May 2016 on remaining issues such as the transparency of charges. The press release for the March guidance said:

> The IFR has brought major changes to the way card payment systems operate in Europe, most notably by introducing caps on interchange fees. Each EU Member State is given local discretion as to the level at which the caps are set within the bands specified in the IFR. In the UK, the Treasury has set the caps at 0.2% of the value of a transaction for debit cards, and 0.3% for credit cards.(2) The caps came into effect across Europe in December 2015.
>
> Interchange fees are often paid by the bank of a merchant (such as a supermarket) to the bank of the card user (such as somebody doing a weekly shop when card payments are made). Traditionally the merchant's bank passes the cost of these fees on to the merchant as part of the 'merchant service charge'.(3)
>
> Before the IFR was introduced, the average interchange fee charged by UK card schemes (for example, MasterCard and Visa) was around 0.8% for credit card transactions. Some premium cards were charged at an even higher rate. The new cap means that the average credit card interchange fee will fall by around 70%.
>
>> Hannah Nixon, Managing Director of the PSR, said:
>>
>> "The intention of the IFR, as well as providing savings to consumers by reducing interchange fees, is to boost transparency and remove barriers so others can enter the market and compete. We will be watching with interest to see how the industry adapts to the regulation.
>>
>> "We know that businesses are keen to see the fee caps reflected in their merchant service charges. Our guidance clarifies the IFR for the UK card payments industry and we

[39] EU Commission; Press release; 10 March 2015

> would expect to see the benefits passed on to merchants in the fees that they pay. However, if merchants remain unhappy they should contact their acquirer and consider shopping around to get a better rate."
>
> As well as the interchange fee caps, the guidance published today also considers which card schemes the IFR applies to, the PSR's approach to monitoring compliance, its powers and procedures under the regulation, and penalties for non-compliance. The guidance is part of on-going work to provide clarity on the IFR and the PSR will consult on further guidance relating to business rules later this year.

The guidance can be found here.

The May guidance focussed more on the transparency of charges, new provisions on which come into force in June 2016. The Regulator commented:

> The interchange fee is only part of what makes up the Merchant Service Charge but we are still being asked by merchants why they are not seeing the cut in the interchange fee being passed on.
>
> It is up to the individual companies to negotiate on the merchant service charge rate, but we would still expect that acquirers pass on reduced costs to merchants and, in turn, that these are then passed onto consumers.
>
> The new transparency should allow merchants more clarity when negotiating fees. However, if merchants remain unhappy they should contact their acquirer and consider shopping around to get a better rate.

The later guidance on the IFR can be found on the PSR website here.

The response of some of the card issuers has been to reduce the value of some of the points–based or cash-back incentive schemes offered by the card companies. RBS, NatWest and Capital One credit cards have all taken such measures. More than anything, this response perhaps best illustrates the complexity and lack of transparency in this area.

3.12 Bank Structural Reform Regulation

(As at April 2016)

The financial crisis exposed the fact that some banks were so large and systemically important that they could not be allowed to fail for fear of the damage they would do to the wider economy. This came to be called 'too big to fail'. This inability to allow them to fail meant that national governments had to bail them out, leading to huge public sector deficits and years of austerity down the line.

EU Response

The Regulation seeks to curtail the artificial expansion of banks' balance sheets, particularly those activities of a purely speculative nature, thereby reducing the risk that tax payers have to step in to save failing banks, and reducing the cost and complexity of any resolution when required. It is also an important complement to the Directive establishing a framework for the recovery and resolution of credit institutions and investment firms ("BRRD").

Structural reform has so far not been part of the international reform agenda agreed by the G20. However, a number of countries have enacted or proposed measures to address the above concerns. In the last years a number of Member States have engaged in reform initiatives (Germany, France, the United Kingdom and Belgium). In addition the United States has adopted the so-called "Volcker rule" which prohibits proprietary trading by banks. Most of the national initiatives have had elements of splitting the functions of banks between safer 'transactional' activity and riskier investment activity.

Where different countries adopt different solutions there is a danger of mobile banks simply moving to the least regulated authority. Hence the standardisation of practice throughout the EU is seen as being important and beneficial to the banks who often operate in multiple countries.

Where countries, like the UK, have already enacted legislation they may make a request to the Commission to grant a derogation from the provisions laid down in Chapter III ("separation of certain trading activities").

The main feature of the proposed Regulation is that it will prohibit large EU credit institutions and banking groups from carrying out proprietary trading and certain related activities.

In due course, the authorities will undertake a systematic review of certain other activities – namely, market-making, investment in/sponsoring of securitization and trading of certain derivatives and decide if separation is required here too.

The proposed Regulation only targets the largest credit institutions and banking groups since the main purpose of the proposal is to deal with residual systemic risks in the EU financial system.

The Regulation is currently ‘on hold’ at the stage of the European Parliament.

3.13 Prospectus Directive

(As at June 2017)

The main EU Commission resource for information about the review of the prospectus directive can be found here. The European Parliament resource is here.

In 2015 the European Commission conducted a consultation which identified shortcomings in the regime introduced by the prospectus directive. For companies, these rules constitute a lot of legal paperwork often running into hundreds of pages. This can be costly and burdensome for businesses, especially for smaller ones. The feedback also showed that it can be difficult for investors to wade through very detailed information.

As the listing authority in the UK, the FCA commented upon the consultation here. It proposed:

> a relatively significant re-structuring of the directive and we highlight how these ideas would support the objectives of CMU. We base our response on the premise that appropriate, well-designed investor protection fosters market confidence, attracting investment and issuers into a virtuous circle that benefits all participants.[40]

Following the consultation, the Commission proposed on 30 November 2015 a regulation which focuses, among other things,

- on creating a lighter prospectus for smaller companies,
- shortening the length of the document and focusing on information that is more pertinent to investors,
- simplifying secondary issuance for listed firms,
- fast-tracking the regime for frequent issuers and providing, through ESMA, a single access point for all EU prospectuses.

As part of its capital markets union action plan, in June 2017 the EU adopted a Regulation to improve the prospectus regime.[41] The regulation aims to

- make it easier and cheaper for smaller companies to access capital
- introduce simplification and flexibility for all types of issuers, in particular for secondary issuances and frequent issuers which are already known to capital markets
- improve prospectuses for investors by introducing a retail investor-friendly summary of key information, catering for the specific information and protection needs of investors

The Regulation can be found here.

[40] Financial Conduct Authority: *Financial Conduct Authority’s response to European Commission Consultation on the Review of the Prospectus Directive*

[41] Regulation (EU) 2017/1129

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