CAPITAL MARKETS UNION PACKAGE

A Cicero/amo overview

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PACKAGE OVERVIEW

The EU's plans to develop and enhance the integration of its Capital Markets Union were delayed by the far-reaching impacts of the COVID-19 pandemic. With the Capital Markets Union package unveiled today, the Commission has presented an extensive array of proposals aiming to ensure the EU financial sector fuels the twin green and digital transitions, and to cement the sector's global competitiveness. The top line ambitions include streamlining access to data and boosting trade transparency for investors and companies, whilst removing ambiguities in the rules covering Europe's equity, bond and derivative markets.

This would particularly impact how **asset managers** run their business due to suggested changing rules under the AIFMD/UCITS review. The changes introduced under the MiFIR review will have significant bearing on the way large **investment banks, hedge funds and other institutional investors** operate within the EU financial rulebook – with several key adjustments to legislation covering derivatives trading, trade transparency and open access. It will also substantially impact how **Consolidated Tape Providers (CTPs)** operate. The envisaged changes will also have significant bearing upon **clearing venues** and **execution venues**, such as **stock exchanges** and **alternative trading venues**.

Timing: The package will now proceed through the Ordinary Legislative Procedure, with the Commission having asked the co-legislators to expedite the process. The French Presidency will aim to accelerate the files as swiftly as possible but we still do not expect adoption before the end of 2022.

- **AIFMD/UCITS DIRECTIVE REVIEW**
- **ELTIF REVIEW**
- **MiFIR REVIEW**
- **EUROPEAN SINGLE ACCESS POINT (ESAP)**

PROPOSALS UNDER THE MICROSCOPE

AIFMD/UCITS REVIEW

As confirmed in our webinar this Wednesday, the Commission is aiming to introduced targeted changes to the Alternative Investment Fund Managers Directive (AIFMD) as well as the Undertakings for the Collective Investment in Transferable Securities (UCITS) Directive instead of an overhaul of the regimes. The Commission is aiming to increase financial stability through a common liquidity management regime, clarify existing delegation rules, increase availability of information for investors, and harmonise supervision.

Specific changes envisioned include:

Delegation

- New minimum stable substance requirements for AIFMs (2 FTEs).
- Increased reporting requirements for AIFs and UCITS management companies (ie detailed information about their composition and activities).
- Delegation rules applies to ancillary services.
- The Commission will also prepare rules on the conditions under which a UCITS management company becomes a letter box entity.

Liquidity management

- Harmonised list of available liquidity management tools across EU Member States, from which AIFMs must select.
- NCAs allowed to request the activation or deactivation of LMTs by AIFMs following notification to ESMA.

Disclosures

- AIFMs must now disclosure to investors their originated loan portfolio, direct and indirect fees and charges allocated to the AIF, establishment of relevant entities by the AIFM, its staff or affiliates, and the LMTs selected by the AIFM.

Supervision

- NCAs are given more power to request enforcement of rules by other NCAs.

Loan origination

- Stricter rules are put in place for loan-originating AIFs including borrowing limits and capital requirements.

Depository passport

- A depositary passport was not introduced, although originally expected. Instead the Commission has opened up cross-border access to depositaries instead.

PROPOSALS UNDER THE MICROSCOPE (CONTINUED)

ELTIF REVIEW

Through the review of the European Long-Term Invest Funds (ELTIFs) Regulation, the Commission is aiming to make this – previously underutilised – financial product, more attractive to European investors and therefore more widely created by European AIFMs.

Specific changes to the Regulation include:

Authorisation

- Authorisation rules are relaxed, with ELTIFs home Member State no longer required to be where their AIFM is based.

Eligible assets

- Eligible assets for ELTIFs have been broadened. A few of the reforms include:
  - allowing minority co-investments;
  - reducing minimum investments from €10m to €1m; and
  - redefining 'real assets' to allow for investments into assets that do not necessarily provide cash flows or investment returns (ie ESG).

Portfolio composition

- Rules on portfolio composition are divided based on the type of investors the ELTIF is being marketed to, with professional-only ELTIFs have lower or no restrictions on their composition, whilst restrictions for mixed ELTIFs are also relaxed.

Borrowing

- Limitations on borrowing have been reduced, allowing for ELTIFs to borrow higher amounts and in different currencies.

Marketing

- Presence requirements for ELTIFs in each Member State they are marketed are lifted.

PROPOSALS UNDER THE MICROSCOPE (CONTINUED)

MIFIR REVIEW

The review of the Markets in Financial Instruments Regulation (MiFIR) fundamentally aims to bring the benefits of more transparency and consolidated market data to Europe's equity markets. Through its review of MiFIR and the introduction of a European "consolidated tape" the Commission seeks to enable investors – particularly smaller and retail investors - to access vital market data prior to investing in shares and bonds. Overall, three core areas for review of MiFIR have been targeted – boosting transparency and availability of market data; levelling the playing field between execution venues (i.e. the place where transactions occur, such as a Stock Exchange or so-called alternative trading venues); and finally boosting the competitiveness of EU market infrastructures on a global level.

It is important to note that while the following legislative measures are contained within the Regulation amending MiFIR, the new proposal introduces targeted adjustments to the Markets in Financial Instruments Directive (MiFID II) to ensure mutual coherence with MiFIR.

The specific changes therefore include:

Single volume cap

MiFID II already places restrictions on the use of transparency wavers to curb "dark" trading, where trading takes place away from transparent trading venues, which leads to significant problems for investors.

The double volume cap on the number of shares to be traded under a transparency waiver is replaced by a single volume cap - set at 7% of trades that are executed under the reference price waiver or the negotiated trade waiver.

Transparency obligations on systematic internalisers

Systematic internalisers (SIs) are the systems investment banks use for trading directly with clients. The proposal increases the public quoting obligations for SIs to cover quotes for trade sizes up to a minimum of twice the standard market size. The proposal also replicates the reference price waiver (RPW) for trades SIs carry out without pre-trade transparency. This means the SIs will no longer be allowed to match small trades at midpoint, in line with the RPW rules.

Preventing alternative trading venues (MTFs) from carrying out small trades under the reference price waiver (RPW)

In line with recommendations from ESMA, the Commission proposes to install a minimum threshold trade size for the RPW, which had allowed trading venues to match orders at prices that reference prices determined by other markets.

Derivatives trading obligations

The derivatives trading obligation under MiFIR is aligned with the clearing obligation for derivatives under the EMIR REFIT regulation (the European Markets Infrastructure Regulation) to enhance legal certainty and clarify which entities fall in the scope of the clearing and trading obligations.

Removing the "open access" obligation for exchange-traded derivatives

Clearing infrastructures in the EU will no longer have to clear derivatives trades that are not executed on their vertically integrated trading platform. At the same time, EU trading venues will no longer need to permit clearing on their platform from non-affiliated clearing infrastructures.

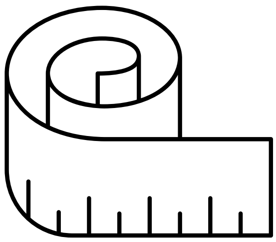
PROPOSALS UNDER THE MICROSCOPE (CONTINUED)

MiFIR consolidated tape in detail: This new tool will consolidate data "as close to real-time as possible" on transactions taking place in EU trading platforms. Investors will thus be able to access in one place the price and key market data about financial instruments. To date, there have been a myriad of different competing consolidated tape providers (CTPs) – under the new rules, ESMA will select a single CTP for each asset class, such as shares, bonds, exchange traded funds and derivatives. All execution platforms will be obliged to share their trading data to the consolidated tape.

The Commission is introducing the following specific requirements for a CTP:
- the collection of consolidated core market data;
- the collection of licensing fees from subscribers;
- for shares, a revenue participation scheme for regulated markets for their contribution of market data.

Timing: Investors will be able to access in one place the price, volume and time of transactions regarding a particular financial instrument, such as a share, bond, ETF or derivative.

Goal: The aim of the tape is to reduce liquidity and trade execution risks for all market participants, and streamline access to market data for investors.



Scope: All execution platforms will be obliged to send their trading data to the consolidated tape.

Best execution: Investors will be able to establish whether they obtained the best price for purchasing or selling shares, bonds, ETFs or derivatives.

Supervision: ESMA will select each consolidated tape provider, and the agency is given new supervisory powers to do this.

Operational cost: The Commission estimates the total cost of setup of a consolidated tape for shares to be €2.2-7.8 million/ year, and for bonds/ derivatives, €1.46-5.4 million/year. Professional users would be charged an annual subscription of €1,200/year, while non-professional users would not be charged.

PROPOSALS UNDER THE MICROSCOPE (CONTINUED)

EUROPEAN SINGLE ACCESS POINT (ESAP)

Through the ESAP proposals, the European Commission is aiming to ensure public and free access to EU-level financial and sustainability-related data across the single market with one single access point. The proposals provide details as to the ESAP's setup (ie ESMA oversight, voluntary nature of certain information disclosures) as well as amendments to a number of existing legislative files in order to make all data currently being provided by businesses in scope be published in a data extractable format or in a machine-readable format and accompanied by a qualified electronic seal.

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