Consultation Next CMU High-Level Group on how to deepen and to improve the Capital Markets Union

Eumedion's response

General remarks

Eumedion welcomes the opportunity to respond to the questionnaire of the Next CMU High-Level Group (CMU HLG) on the possibilities to deepen and to improve the European Capital Markets Union (CMU). Eumedion is the Dutch corporate governance and sustainability forum for institutional investors. Our 65 Dutch and non-Dutch participants represent more than EUR 5 trillion assets under management. They invest for their clients and their beneficiaries in listed companies worldwide.

We very much welcome the establishment of the CMU HLG, its mandate and its tasks to come forward with recommendations to shape and strengthen capital market-based investment and financing for the real economy in the EU 27, in the medium and long term. A fresh impetus to the CMU project is necessary, as the European capital markets have barely become more unified since the launch of the CMU Action Plan in September 2015. While a rebalancing of EU economic structures towards more public and private market-based finance is desirable in order to become less dependent on bank financing, the CMU Action Plan has not been particularly successful in integrating nationally fragmented capital markets, nor have capital markets deepened. Moreover, the 'market-based finance gap' with the United States has grown, rather than declined, and other regions are advancing (e.g. in terms of stock market capitalization (in absolute levels and in % GDP and the average amount invested by venture capital and private equity)). This has affected the competitiveness of EU Member States, EU companies (small, medium ánd large), as well as the credibility of the project itself. The analysis in the 2015 CMU Action Plan and its consecutive action points are – in our opinion – still valid. It is now crucial that the action points are actually implemented.

Given the short timeframe to respond to the questionnaire, we did not have enough time to prepare an "analysis of deep trends and developments (such as digital and artificial intelligence transformation, aging, climate change, UK's decision to leave the EU)" as requested by the CMU HLG and to answer all the questions. Our response is therefore limited to those topics which are most relevant for Eumedion and

its members i.e. disclosures and investor protection. Our members also have flagged a number of obstacles for increasing cross-border investments within the EU. These will be explained in the following sections.

1. Gold plating and Member State options: European regulations rather than directives are needed

Cross-border investment is hampered by 'gold plating' and numerous Member State options. Therefore, institutional investors with a pan-European focus have to take into account 27 separate regulatory regimes when investing in listed companies which have their statutory seat in one of the 27 Member States. Detailed regulations – instead of directives – without Member State options in the areas of financial services would represent an important step towards the creation of a CMU. The regulations should be complemented by European supervision and enforcement.

Before the proposal for a regulation is published, the European Commission should assess whether there are overlapping, duplicating or inconsistent requirements. For example both EMIR and MiFIR contain transaction reporting requirements. Although the subject is the same, the requirements itself are not aligned. As a consequence parties who have to comply with both reporting requirements, for example asset managers, have to spend significant amounts of effort to meet both transaction reporting requirements.[1]

Numerous directives and regulations in the area of financial services contain provisions for so-called 'Level 2' measures to be adopted by the European Commission. As a consequence detailed implementing measures (Level 2) will be adopted following the adoption of the framework legislation (Level 1). Currently the transposition deadlines are linked to the adoption of the framework legislation (Level 1). Nevertheless, for a proper implementation the specifics of the detailed implementing measures (Level 2) are needed as well. Those measures are often adopted much later and as a consequence the transposition deadlines for many legislative packages are too short. To resolve this, the transposition deadline for the whole legislative package could be linked to the adoption of the last detailed implementing measures (Level 2).

Furthermore, regulations are subject to review, generally three years after coming into effect. However, quite often parts of the obligations in such regulation have not taken effect yet, or just recently as a result of the phasing-in or transitional provisions in such regulations. As an example, the EMIR reporting

[1] Reference is made to paragraphs 11-18 of the Final Report Review of the Regulatory and Implementing Technical Standards on reporting under Article 9 of EMIR (ESMA/2015/1645).

obligation did not enter into force until 12 February 2014, while EMIR itself took effect 16 August 2012. Due to the review obligation in EMIR (article 85 stipulated a review by 17 August 2015), the European Commission was obliged to review the effects of that regulation very shortly after it came into effect (or even before its main obligations, in case of EMIR for example the clearing obligations, have taken effect). Such a review usually leads to changes in requirements again. For EMIR reporting for example, market parties have to adjust their reports several times in a row to comply with the Level 2 measures subsequently with the (frequently updated) ESMA Q&A (Level 3), followed by so-called L1 and L2 ESMA validations and lastly by changes proposed as a result of the EMIR review. MiFIR requirements came on top of this in 2018. We do not see the need for such a high frequency of changes to requirements as these lead to substantial additional efforts for the industry and ultimately investors. We therefore advise the European Commission not to start with the review of a regulation until all its obligations have effectively came into effect and a certain period of experience with such obligations has been gained (e.g. market parties have applied the obligations for a minimum period of two to three years).

2. Transforming the Transparency Directive into a Transparency Regulation

The ESMA Practical Guide 'National rules on notifications of major holdings under the Transparency Directive' (latest version: 31 July 2019) shows an enormous variety of national requirements in relation to the notification of major shareholdings under the Transparency Directive. The document shows large differences in national legislation regarding:

- applicable notification thresholds;
- triggering events for (new) notifications;
- triggering event in cases where the exercise of a physically settled financial instrument leads to an acquisition of shares with voting rights;
- deadlines for learning triggering events;
- the deadline for making a notification to the issuer;
- channels for submitting notifications to national supervisors and issuers;
- permitted formats for submitting notifications to supervisors and issuers;
- the deadline for publishing the notification.

Additionally, the initial thresholds for the notification of major holdings do not only differ from Member State to Member State but can also differ from one listed company to another. The Transparency Directive does not prohibit issuers to set additional notification thresholds through a provision in their articles of association. In a large number of Member States investors have to check the articles of association of each company they invest in to find out what the first notification threshold is.

All these differences in national legislation and in articles of association are very burdensome for large institutional investors who – for reasons of diversification – invest in many listed companies incorporated in various countries.

Consequently investors have to make substantial costs to a) monitor the notifications that follow from legislation and, if at all possible, from the articles of association and b) to maintain an adequate and up to date notification system. Therefore, Eumedion calls for full harmonisation of the requirements in relation to the notification of major shareholdings under the Transparency Directive and prefers a Transparency Regulation without any Member State options and a ban on the introduction of additional thresholds in the articles of association. Furthermore, we suggest the introduction of one central EU notification-register and to develop one applicable form for notifications to national competent authorities.

3. Non-binding and non-harmonised reporting frameworks regarding non-financial/ESG information

The attention of investors, companies and legislative bodies for non-financial information has increased dramatically over the last decade. Consumers are increasingly becoming aware of and vocal on sustainability issues. Investors that include non-financial criteria in their investment and voting decisions have become mainstream. The scope of the management reports of many companies expanded to include multiple stakeholders, including the wider society. Many companies have become more committed to long term value creation for all stakeholders, which is reflected in the contents of their annual reports. Reporting on human capital and the strength of customer relations is helping investors understand how they contribute to long term value creation.

The world lacked and still lacks a leading authoritative body that sets non-financial reporting standards for preparing the management report. As a consequence hundreds of reporting frameworks have emerged. None of them combines the full breath of topics with the necessary inroads into measurement. Many of the frameworks overlap and many of the differences between the frameworks are not that meaningful. This poses a major challenge for companies that want to report on non-financial issues. It also poses a major challenge for investors that want to understand how the company creates long term value and live up to the valid needs of society where non-financial performance matters. Requirements for companies actually lag requirements for institutional investors as the EU Sustainable Finance legislative package already requires institutional investors to disclose how environmental, social and governance (ESG) factors are integrated in their investment decision-making and risk processes.

Worldwide harmonisation of reporting standards brings clarity to companies that currently struggle what frameworks to use and have to deal with conflicting measurement requirements. Investors benefit from a reduction in unnecessary high variety of key performance indicators (KPIs), improved comparability and

consistency. A credible framework will also make it easier for auditors to provide reasonable assurance on the non-financial information. The EC Guidelines on non-financial reporting, including its recent supplement on reporting climate-related information, are a first step in reaching harmonisation, but these guidelines are not sufficient. The guidelines are non-binding and companies are not required to obtain external assurance for their non-financial reporting. As a result, the creditability of non-financial reporting will not be comparable with the creditability of financial information. This will become an increasing pressing issue for institutional investors when the EU Sustainable Finance legislative package enters into force.

The laudable efforts of the Corporate Reporting Dialogue (CRD) aim to accomplish this aspired harmonisation with a focus on measurement of non-financial information. However, the CRD includes only a limited number of frameworks and still the dialogue proves to be a rather slow process. Also the rigour of ESG reporting standards is (not yet) near the rigour of financial reporting standards. Eumedion believes that the new European Commission should appoint an independent, authoritative, international standard setter for establishing non-financial reporting standards. The European Commission should also establish a Regulation to require all EU listed companies to prepare their management report and non-financial KPIs in accordance with a single set of international non-financial reporting standards.

4. Non-consistent enforcement of IFRS

From the perspective of an institutional investor it is important to have consistent and comparable reporting by all listed entities, irrespective of their size and the location of their listing. Therefore Eumedion believes that new and/or amendments to existing international financial reporting standards (IFRS) should be fully endorsed – without carve-outs – at European Union level. In line with the Maystadt report.[2] Eumedion is of the view that full endorsement is the only way to achieve the full benefits of IFRS.

Currently we see diverged enforcement of IFRS among Member States. We prefer more harmonisation of the IFRS enforcement regime, so investors can rely on a pan-European enforcement regime. Therefore Eumedion would take the view that the supervision on financial and non-financial reporting by national supervisory authorities should be transferred to a pan-European authority, e.g. ESMA. Accordingly we also believe that the supervision on audit firms should be transferred to the same pan-European authority.

[2] Should IFRS standards be more "European"? Mission to reinforce the EU's contribution to the development of international accounting standards, report by Philippe Maystadt, October 2013 (http://ec.europa.eu/finance/accounting/docs/governance/reform/131112_report_en.pdf).

5. Differences in implementation of the Take Over Bids Directive

The Takeover Bids Directive leaves it to Member States to define the threshold for a mandatory bid. This is the reason why that threshold differs from Member State to Member State: in a range from 30% to 50%.[3] The underlying objective of the Takeover Bids Directive is the protection of minority shareholders when control of their companies has been acquired. Institutional investors such as pension funds, insurance companies and asset managers generally are minority shareholders.The protection consists of the obligation for the party who has acquired control of a company to make an offer to all the holders of that company's securities at an equitable price. There is no logic why the protection of minority shareholders should differ from Member State to Member State. Therefore Eumedion calls for full harmonisation of the mandatory bid threshold. Also the calculation of that threshold should be fully harmonised. Most Member States calculate the threshold on the basis of voting rights alone and do not include derivatives like cash settled equity swaps and cash settled options in the calculation of the threshold.[4] The use of those derivatives may make it possible to bypass the rationale of the mandatory bid rules, which is to offer a realistic exit to shareholders in the event a party acquires control over the company and to provide shareholders with a part of the control premium. Therefore Eumedion believes that consideration should be given to include these derivatives in the calculation of the threshold for a mandatory bid. In addition Eumedion would welcome harmonisation of the treatment of anti-takeover devices in order to achieve clearness on the protection of minority shareholders in public bid situations.

According to the Take Over Bids Directive a party is exempted from the mandatory bid rule if it acquires control as the consequence of a voluntary bid (art. 5 (2)). Shareholders may be confronted with a voluntary bid launched at a low price which allows the offeror to increase its stake just above the mandatory bid threshold without triggering a real exit. The use of a voluntary offer would pose the risk that the rationale of the mandatory bid rule is circumvented. Therefore some Member States apply the equitable price rule not only to mandatory but also to voluntary bids.[5] Eumedion believes that the additional condition of issuing a voluntary bid for an equitable price should be introduced at European level. Another way to protect minority shareholders would be to introduce a minimum acceptance threshold for voluntary offers, e.g. 80%.

[3] The Take Over Bids Directive Assessment Report, p. 291 (http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf).
[4] The Take Over Bids Directive Assessment Report, p. 156 (http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf).
[5] The Take Over Bids Directive Assessment Report, p. 96 (http://ec.europa.eu/internal_market/company/docs/takeoverbids/study/study_en.pdf),

Specific bottleneck in relation to Brexit

A company that is incorporated in the European Economic Area with only a listing in London falls outside the scope of any takeover legislation after Brexit.[6] From an investor protection point of view, this is an unacceptable situation. We urge the European Commission and/or ESMA to come forward with a temporary solution, e.g. that the takeover legislation of the home country would apply or that the company would be required to also have a listing in the EEA.

6. Differences in cluster munitions disinvestment legislation

An increasing number of Member States are developing their own legislation to ban investments in cluster munition producers. The 2008 Convention on Cluster Munitions (CCM) prohibits the use, production, transfer and stockpiling of cluster munitions and is ratified by the fast majority of Member States. Following the CCM, various Member States started implementing legislation that prohibits investments in companies that are involved in cluster munitions. To date, Belgium, Ireland, Italy, Luxembourg, The Netherlands and Spain implemented legislation that prohibits financing of companies involved in cluster munition production. In addition, the governments of Croatia, the Czech Republic, France, Hungary, Slovenia and The United Kingdom released an interpretive statement suggesting that investments in cluster munition manufacturers are considered as prohibited based on the CCM.

The legal requirements for banning investments in and financing of cluster munitions differ between EU-member states, which in turn leads to confusion among investors operating in different EU markets. Eumedion believes that harmonisation of cluster munitions disinvestment legislation would set clear minimum standards for financial institutions operating in several jurisdictions. In addition, clear harmonised standards will provide room for one single compliance framework that will also be beneficial for financial institutions from non-EU countries. Eumedion would encourage the European Commission to implement legislation banning investments in cluster munitions at a European level, based on the criteria set in the CCM.

[6] Given the UK Takeover Panel's Response Statement 2018/2 dated 6 March 2019 on the United Kingdom's Withdrawal from the European Union.