VIEWPOINT

REGULATORY DEVELOPMENTS IN EUROPE: 2015 UPDATE AND ANALYSIS

DECEMBER 2015

BLACKROCK®

"At its most simple, a single market for capital aims to link savings better with growth. By building stronger, more sustainable capital markets, we could increase investment in our infrastructure; give businesses seeking capital a bigger choice of funding; increase opportunities for successful businesses to sell into bigger markets, reducing costs to consumers; and add to the options for people saving for the long term."

– Jonathan Hill, European Commissioner, at the 2015 ECMI Annual Conference[1]

Overview

Regulatory reforms have changed many parts of the financial services ecosystem profoundly and extensively, and a large number of complex and interrelated proposals remain on the table. BlackRock engages in the European legislative process on issues with the greatest potential to affect both retail and institutional clients, and seeks to ensure that the voice of the investor is heard by policymakers and regulators.

Seven years after the 2008 financial crisis, we see a shift in the agenda of global, pan-European and national policymakers. If rebuilding a stronger and more resilient financial system was the focus of the immediate years after the crisis, legislators are now taking stock of what's been reformed so far, and looking forward to enhance the regulatory framework for capital markets and investors to foster growth. This search for balance between the financial stability agenda and the growth agenda is evidenced throughout many of the policy areas touched on in this paper.

This *ViewPoint* serves as a summary of the key upcoming legislative and regulatory proposals impacting savers and investors in Europe. Beginning with a focus on legislation impacting investments, we then consider the plumbing of capital markets, review the latest rules affecting distribution, and end with taxation. We focus on the '21 topics to watch' that are affecting Europe's retail and institutional investors, distributors, product providers, central clearing counterparties, CSDs and many other actors, and also provide an overview of legislation affecting investors in Switzerland.

The opinions expressed are as of December 2015 and may change as subsequent conditions vary.

Investments

Financial stability agenda, driver of regulation

Solvency II: Prudential regime of European insurers

IMPACT ON:	European non-life insurance, life insurance and reinsurance companies
DEC 2013	Final legal text at the EU level
ONGOING	Currently being adopted into national law
1 JAN 2016	Entry into force
SEP 2015	European Commission published rules on calibrations of capital requirements for investment in infrastructure

IMPACT ON CLIENTS, AND BLACKROCK VIEW

Solvency II introduces a prudential regime for insurance and reinsurance undertakings in the EU. It sets the valuation basis for liabilities and determines the amount of capital that insurers and reinsurers need to hold against various market and non-market risks. It also imposes the 'prudent person principal', which requires firms to invest only in 'assets and instruments whose risks it can properly identify, measure, monitor, manage, control and report'.

From an asset management perspective, developing an investment strategy that is efficient under Solvency II is of primary importance for many insurers. The proposed capital requirements for many traditional asset classes have now been largely agreed for some time, but certain asset classes have remained the subject of debate. In particular, Solvency II has been criticised for disincentivising investment into equities and long term asset classes.

The European Commission (EC) however sees infrastructure investment as important for driving growth in Europe, and in 2015 asked the European Insurance and Occupational Pensions Authority (EIOPA) to revisit the regulatory treatment of this asset class. EIOPA published a framework defining 'Qualifying' Infrastructure Investment that would attract a lower capital requirement. Subject to further criteria, certain debt investments may also not need a formal credit rating. Lower capital requirements will enhance the overall capital efficiency for insurance companies investing in infrastructure, and the detailed qualifying criteria may help those new to this space to better understand the risk profile of this asset class.

Securitisation capital requirements have also attracted attention. The European Commission has adopted proposals for a Simple, Transparent and Standardised framework that are set to simplify the European securitisation market, and expects recalibrated Solvency II capital requirements to follow (for details, see page 8).

Key features of Solvency II

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

UCITS V: Protecting fund assets and common standards for fund manager remuneration

IMPACT ON:	Managers and depositaries of UCITS
JUL 2014	Final legal text at the EU level
ONGOING	Currently being adopted into national law
18 MAR 2016	Entry into force
H2 2016	Additional technical measures on depositary requirements expected to come into force (i.e. after the implementation deadline)

IMPACT ON CLIENTS, AND BLACKROCK VIEW

UCITS V aims to:

- Ensure that retail investment funds (UCITS) benefit from the same level of client asset protection as funds governed by the Alternative Investment Managers Directive (AIFMD).
- Align the remuneration requirements for UCITS managers with that under AIFMD, to promote alignment of interests between investor and manager.
- Agree common standards for the application of sanctions in the case of breach of rules by UCITS funds, their manager or their depositary.

We welcome consistency in the treatment of the depositary's duties, bringing about greater alignment with the investor protection measures in AIFMD. We also believe that it is important to ensure managers can operate consistent remuneration policies across all fund types and client mandates.

Under UCITS V, depositaries will be held strictly liable for assets held in custody by themselves or by third-party sub-custodians, leading to restitution of assets that are lost or stolen. Depositaries will also need to ensure managers' tri-party collateral agents (in respect of both securities lending and repo) are appointed by the depositary, to ensure that no interruption to service arises. They will have enhanced duties to oversee assets not held in custody. Authorised and supervised credit institutions, MiFID investment firms and other investment firms with adequate prudential capital capable of meeting claims will be able to act as depositaries.

Key features of UCITS V

- Appointment of a single depositary for each UCITS, disallowing the appointment of multiple depositaries
- Exhaustive list of entities eligible to act as a depositary of a UCITS
- Common duties across Europe of a depositary to keep the assets of the UCITS safe, monitor cash movements to and from the fund, and oversee the fund manager's performance of key functions
- Safe-keeping requirements for depositaries on the financial instruments that may be held in custody as well as for other assets, including segregation requirements for assets that held in custody
- Assets held in custody by a depositary or its delegate should be protected in the event of the depositary or its delegate becoming insolvent
- Depositary liability for the avoidable loss of a financial instrument held in custody, thereby minimising the effect on end investors of Madoff-style frauds
- UCITS management companies should disclose remuneration policies, and comply with certain remuneration principles, covering their key staff

Institutions for Occupational Retirement Provision Directive (IORPD): Reforming European workplace pensions

IMPACT ON:	Workplace pension funds, trustees and governance committees, asset managers and individual members
MAR 2014	European Commission proposal to revise the IORPD released
DEC 2014	Member States have agreed on their position
Q1 2016	• The European Parliament's position is expected to be finalised in January 2016, and will trigger the start of political negotiations between European Parliament, Member States and European Commission • Publication of EIOPA advice on the holistic balance sheet approach • Disclosure of the results of EIOPA's occupational pensions stress test
31 DEC 2016	Once political agreement is reached, Member States will have until 31 December 2016 to adopt the proposal into national law. Implementation may be postponed, depending on the compromise reached in the political negotiations

IMPACT ON CLIENTS, AND BLACKROCK VIEW

The existing IORP Directive (IORPD I) covers Pillar 2 workplace pensions. The 2014 proposal focuses on improving the governance of Institutions for Occupational Retirement Provision or IORPs (i.e. workplace pension schemes) and increasing their transparency towards members and beneficiaries.

The requirement in the proposal for cross-border schemes to be fully funded, i.e. that their assets match their liabilities, has been retained from the first Directive and will continue to act as a disincentive for pension funds to operate on a cross-border basis.

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

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

The requirement for those running the pension scheme to hold qualifications, while well intentioned, could penalise volunteering member / employer-nominated trustees, thereby reducing the pool of individuals available to act. Instead, we recommend introducing a common EU requirement of the level of knowledge and understanding required of trustees (a requirement that already exists in some Member States).

We believe UCITS-style requirements for a depositary may not be relevant for contract-based schemes and it is critical that the depositary's duties of oversight do not conflict with those of trustees.

Key features of IORPD II proposal

- Cross-border schemes should be fully funded at all times.
- A two-page Pension Benefit Statement (similar to the Key Investor Information Document that operates for UCITS) should be provided annually to members for free. It should include information setting out the member's balance and contributions over the past 12 months by both employee and employer and costs; total capital, also expressed as annuity per month; and target benefits at retirement age.
- Risk evaluation to be performed regularly, and should cover the IORPs' overall funding needs; a qualitative assessment of the margin for adverse deviation; and a qualitative assessment of new or emerging risks such as climate change and use of resources.
- Those running the scheme will be required to hold professional qualifications. The Member States and the European Parliament are looking at harmonising this requirement.
- IORPs are required to appoint a depositary for safe-keeping of assets and oversight duties where members and beneficiaries bear investment risk (i.e. DC schemes).
- A sound remuneration policy and its public disclosure will be applied for those who effectively run the institution (i.e. the IORP's trustees or independent governance committees).
- Member States should allow IORPs to invest in long-term instruments not traded on regulated markets and non-listed assets financing low-carbon and climate resilient infrastructure projects.

Benchmarks and Market Indices Regulation: Greater proportionality is key

IMPACT ON:	Benchmark providers and submitters. Limited impact on the users of benchmarks and the market more generally
SEP 2013	Commission proposal for a Benchmarks Regulation released
NOV 2015	Political negotiations between European Parliament, Member States and European Commission - agreement reached
2016	Start of the European Securities and Markets Authority's (ESMA) technical work on implementation measures ahead of entry into force
2017 / 2018 (tbc)	EU benchmarks regime takes effect

IMPACT ON CLIENTS, AND BLACKROCK VIEW

The scope of the Regulation is broad, capturing all financial benchmarks and market indices. Its requirements apply to administrators, submitters and users of interest rate benchmarks, right through to asset managers who may produce composite indices for performance benchmarking purpose.

BlackRock proposed that a qualitative risk-based approach should be at the heart of the Regulation. We continue to believe there isn't credible justification to include all indices and benchmarks in the same regulatory regime. We are encouraged that tailored solutions for the range of benchmarks and indices will be permitted under the final proposal.

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

In our view, the global International Organization of Securities Commissions (IOSCO) Principles for Financial Benchmarks of 2013 are a sound basis by which the non-critical benchmarks could be deemed equivalent with other jurisdictions.[2] It appears unlikely that jurisdictions other than the EU will introduce comparable legislation to regulate all indices and benchmarks.

DIFFERENCE BETWEEN A REGULATION AND A DIRECTIVE

- A **Regulation** is a pan-European legislative act that applies directly to the Member States.
- A **Directive** is pan-European legislative act that Member States should implement in their national law.

Key features of Benchmarks Regulation

- The Regulation sets out to:
  - Improve the governance and controls over the benchmark administration and compilation process
  - Improve the quality of the input data and methodologies used by benchmark administrators
  - Ensure that contributors to benchmarks provide adequate data and are subject to adequate controls
  - Ensure adequate protection for consumers and investors using benchmarks
  - Ensure the supervision and viability of critical benchmarks
- Importantly, initiatives seeking to regulate the administration of, submission of data to and use of benchmarks do not currently exist outside of the EU legislative process, creating problematic market access issues for non-EU benchmark providers.

Shareholder Rights Directive (SRD): Greater transparency and long-term focus in corporate governance

IMPACT ON:	Pension funds, insurance companies, listed companies and asset managers
APR 2014	European Commission proposal released
OCT 2015	Political negotiations between European Parliament, Member States and European Commission started in October
Expected in 2016	Political agreement between the three institutions on a single text (expected)
Once political agreement is reached, Member States will have 18 months to adopt the Directive into national law	

IMPACT ON CLIENTS, AND BLACKROCK VIEW

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

The proposal requires asset managers and institutional investors to disclose their shareholder engagement policy. BlackRock supports the publication of shareholder engagement policies, including voting records. However, information disclosure should be meaningful, and enable the public to understand how asset managers and asset owners apply their corporate governance principles. Excessive detail (such as the proposed explanation of the voting rationale for each vote cast) may simply obscure the overall picture.

SRD requires pension funds and insurers publicly to disclose their equity investment strategy, how this is aligned with their liability profile and contributes to the long-term performance of their assets. We believe, however, that the disclosure requirement should be directed to the clients (i.e. the pension fund members or insurance policyholders) rather than the general public, as part of their fiduciary duty towards their clients.

SRD introduces measures to align executive remuneration with the long-term business strategy and interests of the company. We support this. However, if regulation places too great a focus on pay and a binding vote, it risks diverting shareholder and company attention away from strategic and governance issues (such as board composition, succession planning, business strategy and execution). These issues are far more critical to sustainable long term business performance.

Key features of SRD proposal

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

Money Market Fund Regulation (MMFR): The state of stable NAV funds in question

IMPACT ON:	All European domiciled money market funds, includes both prime and government funds
SEP 2013	European Commission proposal for an EU MMF Regulation released
APR 2015	European Parliament position differed from the Commission
ONGOING	Currently under negotiations among Member States, discussions not progressing quickly
END OF 2016 (at the earliest)	Political agreement expected
END OF 2016 (at the earliest)	EU MMF regime likely to take effect

IMPACT ON CLIENTS, AND BLACKROCK VIEW

In recent years, the Money Market Fund (MMF) industry has seen considerable changes globally as a result of challenging market conditions and ongoing reform discussions. While the US is in the process of implementing its own rules, European discussions have progressed more slowly.

MMF reform in Europe – especially the structural question of the future of stable NAV (CNAV) funds – has proven particularly divisive. Some Member States would prefer to see the industry transition to a floating NAV (VNAV). Others would like to see the CNAV model remain, with appropriate modifications.

Finding a middle ground has proven challenging, and discussions among Member States have stalled. Europe is unlikely to implement the reforms that the US has adopted, but rather look for a solution that can bridge the gap between those who want to preserve CNAV funds, and those who want to see a full transition of European-domiciled funds to VNAV.

The European Parliament's position points to a possible path forward: a Low-Volatility NAV (LVNAV) fund, that would allow the fund to retain CNAV-like features (pricing to two decimal places, ability to deal on a constant share price) during normal market conditions, but to switch to VNAV during times of market stress. BlackRock believes this could represent a workable compromise, and meet the financial stability objectives of policymakers, provided that a number of details are refined and agreed. We believe LVNAV will be a viable option, as long as it retains the features that investors value most: intraday liquidity and operational ease of use.

Key features of the European Commission MMFR proposal

- New transparency and disclosure obligations, fund-level liquidity requirements, and portfolio composition rules (diversification, concentration, minimum WAM, WAL requirements) for all MMFs (both CNAV and VNAV, and both short-term and standards MMFs)
- Ban on fund-level ratings
- Restrictions on some eligible assets, including some types of ABCP and reverse repo.
- 3% capital buffer for CNAV MMFs intended to make CNAVs more resilient

Key differences in the European Parliament position on MMMFR

- Removal of fund-level rating ban
- Deletion of the 3% capital buffer, however, ban on prime CNAVs as currently constructed
- Creation of three new types of MMFs to replace current CNAVs:
  1. Retail CNAV that is available to a very limited group of investors: e.g., non-profits, local governments
  2. EU Government debt CNAV (limited to EU currencies only)
  3. Low-Volatility NAV fund, which is intended to function as CNAV during normal market conditions, but deals on a variable price during times of market stress

Market-based finance agenda, an additional driver of regulation

European Long-Term Investment Fund (ELTIF) Regulation: The infrastructure and SME investment vehicle for smaller investors?

IMPACT ON:	Institutional and retail investors, asset managers
APR 2015	Political agreement on the ELTIF Regulation reached
ONGOING	ESMA is currently working on finalising technical measures (on costs disclosure, valuation and facilities for retail investors)
9 DEC 2015	ELTIF regime took effect

IMPACT ON CLIENTS, AND BLACKROCK VIEW

The ELTIF is a closed-ended investment fund (with limited ability to offer redemptions), which can be marketed to both retail and institutional investors. It supports the EU agenda to drive long-term sustainable growth by investing in infrastructure projects, unlisted companies or listed SMEs, or real assets such as real estate, ships or aircraft. Short-selling, exposure to commodities, securities lending and repurchase transactions are excluded and derivatives must only be used to hedge risks to which the portfolio is exposed.

BlackRock believes that the ELTIF will potentially be most attractive to smaller institutional investors who do not have dedicated teams looking at the asset classes. Larger institutions may also use the ELTIF provided they benefit from appropriate incentives such as more favourable capital charges under the Solvency II for insurance companies.

Wealth managers may also favour ELTIFs as a way of diversifying client exposures. However, mainstream distributors may find the designation of the ELTIF as a 'complex product' and the retail entry ticket and monitoring requirements may prove to be too cumbersome to incorporate into existing distribution models.

We believe that ELTIFs investing in the following asset classes may potentially be attractive to our clients:

- Unlisted companies, allowing managers to access the illiquidity premium linked to successful small and mid-cap companies
- Private credit, such as loans replicating the success of US registered investment companies or business development corporations
- Infrastructure, especially if more favourable Solvency II capital weightings for insurers are given to investments directed through ELTIFs
- Real assets, especially with the increasing interest in impact investing from institutional clients

Key features of ELTIF Regulation

- The ELTIF is a closed-ended fund marketable to retail and institutional investors, and forms part of the European Commission's agenda to drive long-term investment and growth.
- 70% of an ELTIF's investments should be on eligible investment assets, which include equity and debt instruments and loans by the ELTIF to non-listed non-financial entities and listed SMEs with a maximum capitalisation of €500 million, real assets, commercial property, and infrastructure, subject to diversification rules.
- Up to 30% of the ELTIF's portfolio may also be held in UCITS-eligible assets such as liquid transferable securities.
- Short selling and investment in commodities and derivatives other than for hedging will not be permitted, with further restrictions on securities lending, securities borrowing, repurchase transactions.
- ELTIFs may be marketed to retail and professional investors as defined by MIFID II, with the manager or the distributor required to provide investment advice to retail investors.
- ELTIFs are structured for a fixed term, in principle without early redemption rights though managers may make early capital distributions when underlying assets mature before the end of the fixed term. With shareholder approval may also extend the fixed term helping to avoid sales at an undervalue.
- UCITS can invest in ELTIFs to the extent that is allowed by the UCITS Directive (only ELTIFs investing in SMEs likely to be eligible).
- ELTIFs will receive priority for applications for EIB financing, recognising them as a priority tool to accomplish the long term investment and growth agenda.

European Fund for Strategic investments (EFSI): The framework for increasing investment in the real economy?

IMPACT ON:	Pension funds, insurance companies and asset managers
JAN 2015	European Commission proposal for an EFSI Regulation released
JUN 2015	Final legal text agreed
End of 2015	EFSI is expected to be fully operational
2018	The end of the EFSI programme (envisaged)

IMPACT ON CLIENTS, AND BLACKROCK VIEW

EFSI aims to deliver €315 billion to fund EU infrastructure and SMEs, by encouraging the funding of projects that would not otherwise meet the existing criteria of the European Investment Bank (EIB). EFSI is a €16 billion guarantee from the EU budget, complemented by an allocation of €5 billion of EIB's own capital. Based on an endowment of €21 billion, EFSI's objective is to mobilise investment worth €315 billion, thereby multiplying the initial seed capital by a factor of 15. We believe that EFSI and its various components have the potential to better connect investors with projects and firms in need of additional long-term investment. We welcome the focus on delivering the transparency and stability needed by infrastructure investors.

The European Investment Advisory Hub aims to bring together market participants. Involving national commissioning bodies will have the benefit of encouraging consistent national practices. We call for a proactive approach which focuses on extending the breadth of offerings in the market, e.g., by aggregating smaller projects so that they become of investable size.

The EFSI Project Pipeline, set up to improve investor awareness of existing and future projects, can add value by including a wide range of opportunities including those which are not eligible for direct EFSI funding. The pipeline's value add will increase if it includes investor due diligence criteria in the portal's design. We recommend including sufficient descriptive fields with detailed guidance of the types of information investors need to see.

The list of EFSI eligible investments is long, and we welcome the economic viability and additionality tests. It is important that the Investment Committee is able to act independently to avoid any watering down of economic viability. It is critical that EFSI funding does not lead to a crowding out of private sector investment by financing otherwise viable projects.

For more details, see our *ViewPoint*: Infrastructure investment: Bridging the gap between public and investor needs

Key features of EFSI

- EFSI eligible sectors: research, development and innovation; energy; transport infrastructure; information and communication technologies; environment and resource efficiency; human capital, culture and health; support to SMEs and mid-cap companies
- Leverage / crowd-in private sector and third parties
- 'Additionality' vs existing instruments: Higher risk-taking than EIB normal activity
- Investment Platforms: Pooling of projects with thematic or geographic focus; separate account or fund; can benefit from EU Guarantee via EIB; operation with EU National Promotional Banks
- Size of investments: EIB uses min €25m for individual loans. Smaller schemes can be grouped together
- Governance: Steering Board (consisting of European Commission and EIB officials); Investment Committee (eight independent experts which take decisions on the use of EU guarantee for each operation based on Investment guidelines) and a Managing Director and Deputy Managing Director for the daily management
- European project pipeline: A transparent pipeline will inform investors about existing and future projects

Simple, Transparent and Standardised (STS) Securitisation Regulation: Encouraging the revival of the European securitisation market

IMPACT ON:	Securitisation issuers and sponsors, securitisation investors (e.g. pension funds, insurance companies, banks and investment funds)
Original risk retention rules agreed in CRD II (2009), extended to some other investors subsequently: AIFMD (2011), Solvency II (2009)	
SEP 2015	European Commission proposal for a STS Securitisation Regulation released
DEC 2015	Agreement between Member States on common position
H1 2016	Discussions within the European Parliament
Q2-Q3 2016	Final political agreement
Q4 2016	The Regulation could take effect (tbc, based on date of its publication)

IMPACT ON CLIENTS, AND BLACKROCK VIEW

Following the financial crisis, one of the EU's first regulatory actions was to implement requirements concerning the risk retained by the originator, sponsor or original lender of a securitisation. However, the initial rules in CRD II and then AIFMD and Solvency II placed the responsibility to verify this retention with the investor. The resulting framework created uncertainty in many parts of the investor community, and increased the cost and compliance burden for investing in securitisation.

As the political agenda has moved towards stimulating growth, one of the top priorities is restarting the securitisation market. Building on the work of global and European regulators, the September 2015 proposal intends to create a more coherent legislative framework for investment in securitisations, with obligations more equally shared by the sell-side and the buy-side. The proposal extends investor due diligence requirements to all institutional investors.

Simple, Transparent and Standardised (STS) securitisations – those that meet a range of largely qualitative criteria intended to minimise additional 'structural' risks – will benefit from a more favourable risk weighting under various prudential frameworks (e.g., CRR II, Solvency II) than those securitisations that do not meet the standards.

Alongside many other industry stakeholders, we welcome the proposal. However, some concerns remain surrounding the mechanisms by which the STS designations are made, and the appropriate calibration of STS framework for short-term securitisations (Asset Backed Commercial Paper (ABCP)). The effect of inappropriate STS ABCP criteria could be significant, as potential regulatory restrictions on the ability of MMFs (as described on page 5) to invest in non-qualifying programmes, would cut into the largest investor base for European ABCP programmes. While the Member States made some notable changes to the ABCP provisions during their consideration of the text, we continue to believe that further improvements can and should be made to the text. The European Parliament's consideration of the text will be critical in this regard.

Key features of STS Securitisation proposal

- Direct obligation on securitisation originators, sponsors and original lenders to retain 5% of the net economic interest and to disclose relevant information to investors (as opposed to obliging investors to verify that originators / sponsors / original lenders comply).
- Extension of investor due diligence requirements to all types of institutional investors (currently they only apply to banks, alternative investment fund managers, applicable to insurers as of 1 January 2016).
- Qualitative criteria set out to define 'STS' term ABS.
- ABCP programmes can also benefit from STS label, but criteria apply for both the programme itself, and the underlying transactions.
- Issuers 'self-certify' compliance with the STS criteria – the issuers face strict sanctions and the potential to lose their ability to certify STS compliance for future transactions if the transactions do not meet the criteria at or after certification.
- Separate legislative proposal to amend the CRD II framework looks at both the capital calibrations and the Liquidity Coverage Requirement.
- Measures to update Solvency II risk weights for STS securitisations expected in 2016 – it is unclear how the STS designation will fit with the existing Type 1 / Type 2 rules in the current Solvency II framework.

Developing a Pan-European Personal Pension (PEPP) product for European citizens

IMPACT ON:	Individuals looking for a personal pension, insurance companies, asset managers and other pension providers
JUN 2015	EIOPA issued its latest consultation proposal for a standardised European personal pension product
BY FEB 2016	EIOPA to publish advice for the EC on the potential for an EU internal market for personal pensions
AFTER FEB 2016	European Commission proposal expected as part of the CMU Action Plan (see Box 1), further to EIOPA's advice

IMPACT ON CLIENTS, AND BLACKROCK VIEW

The PEPP aims to encourage more EU citizens to save for an adequate retirement income by providing a standardised Pillar 3 EU personal pension. The PEPP would complement schemes existing at the national level: state (the so-called Pillar 1), workplace (Pillar 2) occupational schemes and national personal pensions (Pillar 3). Standard features include a specific authorisation regime for PEPP managers, common rules on product design (such as diversification, eligible assets and the ability to transfer between PEPP providers) as well as rules on selling practices to ensure the product meet the best interest of customer.

Further analysis of the likely demand for the PEPP on a country-by-country basis will help identify those who will most benefit from the PEPP and drive better product design. Clear duties and liabilities for each participant along the distribution chain will encourage greater engagement. To reduce distribution cost, the proposal focuses on online sales, which may be possible with the support from traditional sales channels (e.g., telephone helplines). Although designated to be sold as a stand-alone Pillar 3 pension, employer support will be critical to the PEPP's success. BlackRock believes they will only be supportive (e.g., by setting up payroll deductions) if they benefit from an appropriate safe harbour against liabilities from misselling the product to employees.

Effective administration will be core to the success of the PEPP. The operation of an administration platform requires a high degree of certainty to minimise operational risk, especially for domestic tax reporting, and high volumes to make it economically viable and support the ongoing development costs. The way forward could be a public-private partnership between the EU, Member States and the private sector to develop a common administrative platform, provide the necessary sponsor support and reduce unnecessary national barriers.

Key features of PEPP proposal

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

BOX 1: THE CAPITAL MARKETS UNION: FACILITATING MARKET-BASED FINANCE AND REMOVING NATIONAL BARRIERS IN EUROPE

The Capital Markets Union is one of the key political projects for the current Commission – the aim is to promote greater diversification of funding sources for European companies, who currently rely heavily on bank funding. More specifically, the project sets out a number of priorities to remove barriers to the free flow of capital in Europe, and increase the role that market-based finance plays in intermediating capital to European companies. The European Commission's Action Plan / roadmap, published in September 2015, focuses on 6 main themes and specific areas underneath which will shape the Commission's work plan until 2019.

1. Financial innovative start-ups and non-listed companies

- Create a more robust Venture Capital marketplace in Europe
- Private instruments: Encourage loan origination from investment funds, develop a secondary market for loans, and create a functional EU private placement market

2. Making it easier for companies to raise capital on public markets

- Focus on encouraging listing and the broader IPO environment
- Review the functioning of corporate bond markets, including looking at the benefits of promoting increased standardization on a voluntary basis

3. Encouraging infrastructure and sustainable investment

- Set up the European Fund for Strategic Investments
- Focus on green / sustainable investment

4. Encouraging greater retail investment participation through investment funds

- Focus on disclosure / transparency and access to quality investment advice
- Study of the efficiency of fund marketing / distribution rules in the EU (incl. administrative and tax barriers in host countries)
- Further work on a pan-European personal pension product

5. Ensuring markets support bank lending by reviving securitisations

6. Addressing structural barriers such as insolvency law, tax, and supervisory convergence, in EU markets

The CMU is not a legislative initiative in and of itself, but a conceptual framework delivered through legislative and non-legislative initiatives. Equally, the CMU will be used as the lens through which all other initiatives (including the implementation of many pieces of already-agreed legislation or issues currently under consideration detailed in this paper) are taken forward: that is to say, does a particular piece of legislation bring us close to, or further away from, achieving the goals of the CMU.

The Prospectus Directive review

The second initiative under the Capital Markets Union, announced on 30 November 2015, is the Commission's review of the Prospectus Directive, which underpins the dual objectives of investor protection and market efficiency through information disclosure requirements for listed companies. The review seeks to ensure that the cost and level of detail of disclosure remain appropriately balanced, and that the Prospectus remains an efficient gateway to the market, facilitating the flow of capital from investors to European companies. BlackRock is supportive of the intent behind the review, and recommends using the opportunity to address overlap with other disclosure regimes (e.g., the PRIIPs KID). We are encouraged by the re-introduction of some flexibility into the format of the disclosure document where this makes information more meaningful to the user, and managing prospectus length by allowing the use of 'incorporation by reference'. We are also analysing proposals from the perspective of the relationship between the revised requirements, primary market issuance practices and secondary market liquidity in fixed income.

BlackRock view

The Capital Markets Union should work in the interest of the savers and institutional investors that represent the 'Capital'. Markets should complement, not replace, the role of bank lending to a greater degree moving forward.

- Policymakers should focus on encouraging and enabling Europeans to save more effectively.
- As a funding source for companies, public markets are likely to offer the most significant economic benefits.
- We see merit in looking for ways that capital markets can help banks to clear room on balance sheets and encourage new lending.
- We see valuable incremental growth in the medium term, but achieving scale in private credit markets is a longer-term challenge.
- A coherent, stable and investor-centric regulatory framework will reinforce investor confidence (e.g., accounting and tax rules).

For more details, see our *ViewPoint*: The European Capital Markets Union: An Investor Perspective

Capital markets infrastructure

Trade execution: Rolling out equity-style transparency across all asset classes

IMPACT ON:	Many of the new requirements are intended to be positive for the market as a whole. The changes will create inevitable challenges to firms to implement whilst the impact on market efficiency and liquidity is still to be determined given the detailed rule making is still to be agreed.
JAN 2014	Political agreement on an updated Markets in Financial Instruments Directive (MiFID) and a new Markets in Financial Instruments Regulation (MiFIR), collectively 'MiFID II'
OCT 2015	Publication by ESMA of draft detailed implementing measures (Regulatory Technical Standards – RTS) on equity and non-equity transparency
DEC 2015	Commission publishes final Delegated Acts on research and investor protection (see page 15)
Implementation of MiFID II was originally planned for 3 January 2017. Negotiations are currently underway to delay by a year to January 2018.	

IMPACT ON CLIENTS, AND BLACKROCK VIEW

MiFID II updates the existing market structure regulatory regime in Europe. Pre- and post-trade transparency requirements will be introduced for 'equity-like' instruments i.e. Exchange Traded Funds (ETFs) and 'non-equity' instruments (fixed income, structured finance products and derivatives). These requirements will apply across all trading venues.

Although the new transparency regime will be tailored to the instruments in question, it is still to be decided how the new regime for 'non-equity' trades will be adjusted. Unlike equities, the 'non-equity' space is extremely diverse, typically fragmented and inventory-based. It is also characterised by low or dispersed liquidity. BlackRock has raised concerns that an inappropriate classification of fixed income instruments whereby illiquid instruments are deemed to be liquid, could undermine the efficient allocation of capital from investor to company. We made recommendations to minimise the impact of these requirements on investors, companies and overall market efficiency. ESMA took on-board such feedback and revised its approach. The rules take a different approach to classifying thresholds, with the result that the thresholds are now more bespoke to the type of instrument, and are regularly updated to capture market changes.

MiFID II should deliver the long-awaited pan-European trade reporting known as the consolidated tape, for equity and equity-like instruments. This aims to offer the most current information available and be accessible on a reasonable commercial basis, with prices disclosed throughout the trading day. BlackRock is supportive of this consolidated view of market liquidity. This will facilitate more informed price discovery and could well lead to increased liquidity across European markets. Further, this will help investors gain a more complete picture of an equity or equity-like instrument's liquidity across trading venues.

Key features of the MiFID II rules impacting market transparency

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

Market structure: Fixing the plumbing of European corporate bond markets

IMPACT ON:	Potentially significant beneficial effect for all fixed income investors over the longer term
ONGOING	Work is ongoing on the potential of current regulatory reform (MiFID II) to address market development and standardisation issues
BY END 2017	European Commission committed in the September 2015 CMU Action Plan (see Box 1) to review EU corporate bond markets, focusing on how market liquidity can be improved

IMPACT ON CLIENTS AND BLACKROCK VIEW

Policy makers have recognised that bond markets are an important source of capital financing for the European economy. However, bond market structure has not kept pace with changes to its participants and the overall growth in the number of bonds outstanding. As a result, the European Commission plans to review EU corporate bond markets, with a focus on finding solutions to potential liquidity challenges investors may face in such markets.

Policymakers expect that the fixed income market will identify its own solutions to address potential liquidity issues that exist as a result of the current market structure. BlackRock agrees with this assessment. Further, we believe that policy makers could encourage and / or incentivise these changes to occur more quickly by calling for market participants to work together to modernise aspects of the fixed income market structure and create better alignment with the structural changes that have taken place.

Our view is that all parts of the ecosystem could adapt behaviours to address the liquidity challenge:

- **Trading venues (including banks):** support the development and adoption of new and existing products that help market participants address challenges associated with changes in fixed income markets. Greater use and acceptance of all-to-all trading venues, where multiple parties, from both the buy-side and the sell-side, can come together to transact (e.g., MarketAxess' ECN) would provide opportunities to increase liquidity.
- **Buy-side**: adjust trading behaviours to not just be a price taker but also a price maker where it helps investors obtain more market liquidity at a better price.[3]
- **Issuers**: while liquid (or 'benchmark') issues are less applicable for smaller issuers or those that do not issue bonds frequently, the market would benefit from larger issuers incorporating a greater use of benchmark issues into their capital structures. This could be brought about by large and frequent issuers migrating to more standardised features over time, thereby concentrating liquidity in fewer and less distinct bonds.

As monetary policy gradually normalises and interest rates eventually rise, the flexibility that issuers currently enjoy will be reduced with multiple bonds that trade infrequently translating into higher borrowing costs for issuers over time. Therefore, BlackRock believes it would ultimately be in issuers' best interests to consider the issuance of their bonds on a more macro level (i.e. through the economic cycle) and potentially act as stewards of the market by moving towards more benchmark issues.

Key features of European Commission bond market liquidity work

- The European Commission will review the functioning of EU corporate bond markets, focusing on:
  - How market liquidity can be improved
  - The potential impact on liquidity of regulatory reforms
  - Ancillary market developments to alleviate the liquidity challenge
  - How voluntary standardisation of offer documentation could lead to greater use of benchmark issues
- Further specific details of this work will become evident ahead of the self-imposed deadline of end-2017 for this work.

Clearing: Bolstering CCP resilience, while planning for recovery and resolution

IMPACT ON:	Investors using derivatives as part of their chosen investment strategy (hedging or taking a market view).
2012	Entry into force of the derivatives regulatory regime under European Markets and Infrastructure Regulation (EMIR)
MAR 2014	The first Central Clearing Counterparty (CCP) was authorised under EMIR
MAY 2015	EMIR Review launched
Expected beginning of 2016	European Commission has split CCP resilience from CCP resolution and recovery and is to include resilience in the EMIR review Report
START OF 2016	Commission expected to publish its new proposal on CCP recovery and resolution. The proposal is expected to include also new powers for ESMA to 'switch-off' a clearing obligation under special circumstances
SPRING 2016	The date of publication of Regulatory Technical Standards (RTS) will trigger the date at which the clearing obligation takes effect
AUGUST 2017	Exemptions from mandatory clearing for risk reducing transactions of eligible pension funds remain in place until August 2017

IMPACT ON CLIENTS, AND BLACKROCK VIEW

The practice of clearing derivative trades through a central infrastructure removes much of the counterparty risk inherent in bilateral transactions – the rationale underpinning the EMIR. It also brings the benefits of greater transparency for derivative market participants, and regulators.

At the same time, central clearing concentrates risk in a handful of the Central Clearing Counterparties (CCPs). Investors are required to use CCPs – and often there isn't a choice of CCPs in a given product. This means that the resilience of CCPs, as well as limiting the extent to which investor monies are exposed in the event of CCP recovery and / or resolution are of great importance.

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

CCP recovery: End-investors using CCPs, such as pension funds and insurance companies, deposit money in good faith. Undermining that trust by hair cutting Initial Margin (IM) and / or Variation Margin (VM) in the course of recovering a failing CCP or resolving a failed CCP will erode investor confidence in clearing and could have systemic pro-cyclical effects.

Key features of the EMIR Review and expectations for CCP recovery and resolution legislation

- In its review of EMIR, the Commission assessed a number of specific aspects of the Regulation. These include:
  - the access of CCPs to central bank liquidity facilities
  - reporting requirements under EMIR
  - the functioning of supervisory colleges for CCPs
  - the margin practices of CCPs
- Details of the EU CCP recovery and resolution proposal are still to be confirmed but we would expect it would follow closely global principles on the issue developed by the Committee on Payments and Market Infrastructure (CPMI) and IOSCO.[4] We could expect:
  - Maximum flexibility on toolbox – aiming not to mandate or exclude any of the CPMI-IOSCO toolbox options
  - Alignment with the Bank Recovery and Resolution Directive (BRRD) – except for the point of non-viability (PoNV) and intervention by authorities which is likely to be left for more subjective compared with BRRD quantitative criteria for PoNV

  Therefore, IM haircutting should not be an option, and VM haircutting considered only as a recovery tool of last resort, subject to strict conditionality of eventually recovering the haircut funds to users.

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

Settlement: Harmonised rules but with unintended consequences on liquidity

IMPACT ON:	Central securities depositories (CSDs), issuers, trading entities, trading venues
JUL 2014	Political agreement on the Central Securities Depositories Regulation (CSDR)
SEP 2014	Entry into force of CSDR
OCT 2014	T+2 adoption for most European markets
JAN 2015	T+2 Regulation applies
MID-2016	Implementation of the CSDR Settlement Discipline – likely to be delayed as per ESMA's recommendation to the European Commission. The EC needs to decide how to go forward – if not earliest application of mandatory buy-ins for mid-2016
SEP 2019	Deadline for European Commission review of CSDR

IMPACT ON CLIENTS, AND BLACKROCK VIEW

The CSDR aims to harmonise the securities settlement cycle and settlement failure regime within the EU.

BlackRock supports a consistent regulatory framework across European CSDs in matters such as buy-in regimes. We consider this to be an important step forward to streamlining efficiency and reducing the associated costs and complexity arising from European market structure end-investors face today. To avoid regulatory arbitrage and related post-trade technical challenges, we have encouraged ESMA to design the rules for CSDR implementation to allow for very limited, if any, scope for Member States to deviate from the ESMA standard.[5]

Consistency is particularly important for ETFs that are cross-listed in several European jurisdictions. Establishing the same buy-in procedures or fail penalties notwithstanding the trading, clearing or settlement venue, as the CSDR requires, would provide investors consistency of outcome and eventually reduced cost. That harmonisation can only be effective if the penalties are only issued by one part of the market infrastructure (i.e. the trading venue or the CCP or the CSD). Currently there can be multiple levels of penalty fails in addition to different failed trade regimes, resulting in distortions across European capital markets.

However, the inclusion of a mandatory buy-in regime in CSDR, which requires buy-in all along the chain of a settlement fail, has proven to be highly contentious. An ICMA study published in February 2015 illustrates that if, or when, mandatory buy-in regulation is implemented (scheduled for early 2016), liquidity across secondary European bond and financing markets will reduce significantly, while bid-offer spreads will widen dramatically, resulting in higher costs for end-investors. The results suggest that even the most liquid sovereign bonds will see bid-offer spreads double, while secondary markets in less liquid corporate bonds may effectively close. The survey further suggests that for many less liquid bonds, including sovereign and public issues, market-makers will retrench from providing liquidity altogether.[6]

Key features of CSDR

- A mandatory securities settlement discipline will include mandatory buying-in and mandatory cash penalties for failed settlements.
- The authorisation and supervision of EU CSDs is harmonised.
- Certain settlement aspects, such as dematerialisation of financial instruments is also harmonised. This means that the securities will be held in electronic form, much like cash is held in a bank account.
- The standard securities settlement cycle is reduced to t+2.

The distribution landscape

MiFID II: Regulation creating new model distributors?

IMPACT ON:	Retail investors and institutional investors, distributors, wealth managers and asset managers
JAN 2014	Political agreement on an updated Markets in Financial Instruments Directive (MiFID) and a new Markets in Financial Instruments Regulation (MiFIR), collectively 'MiFID II'
OCT 2015	Publication by ESMA of draft detailed implementing measures (Regulatory Technical Standards – RTS) on equity and non-equity transparency
Expected DEC 2015	European Commission publishes final Delegated Acts on research and investor protection
Implementation of MiFID II was originally planned for 3 January 2017. Negotiations are currently underway to delay by a year to January 2018	

IMPACT ON CLIENTS, AND BLACKROCK VIEW

MiFID II aims to enhance investor protection in existing distribution channels through upgrades to client servicing models. Even though we still await the specific details to be set out in EU and national implementing rules (see following article), it is clear MiFID II represents significant change for many.

Key to enhancing the investor's experience are changes to suitability rules. These include requirements to ensure that point of sale assessments are regularly updated to ensure distributors maintain an accurate picture of both the client's risk profile and investment portfolio. BlackRock believes that justifying the relative cost and complexity of products in the client's portfolio and understanding the relevant target market for specific products will lead to improved risk profiling. Product manufactures will need to provide more data on how their products perform and build more holistic product development processes, e.g., by drawing on lessons from behavioural finance.

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

BlackRock is concerned that MiFID II risks increasing the cost of servicing mass retail investors, potentially creating an advice gap. Regulators and industry are actively considering how the mass market will access financial advice in the future, especially through the use of technology such as robo-advice.

Key features of the MiFID II rules impacting distribution

- Investor protection:
  - Target market analysis for product sales
  - Revised suitability and appropriateness regime especially for 'complex' products. Enhanced focus on the relative cost and complexity of products and greater focus on the ongoing suitability of products.
  - Ban on retention of inducements by independent advisors and discretionary portfolio managers
  - Quality enhancement required for non-independent advisers and execution only platforms
- **Cost disclosures**: Transparency to the client on the total cost of investing including total costs charged by the MiFID firm for advice/management and the costs charged by the products in which the client is invested.
- **Product governance:** Product manufacturers are required to enhance their processes and build greater connectivity with intermediaries especially in respect of the target market for their products.

MiFID II, PRIIPs and UK FCA / DWP initiatives: Enhancing cost transparency for EU and UK investors

IMPACT ON:	Individual and institutional investors, product manufacturers and advisers
MID-2016	Final implementing rules of the Key Investor Document (KID) for packaged retail and insurance-based investment products (PRIIPs)
FROM APR 2016	New UK requirements on tax treatment and lifetime allowance for pension savings for pension funds
31 DEC 2016	PRIIPs Regulation takes effect
Implementation of MiFID II was originally planned for 3 January 2017. Negotiations are currently underway to delay by a year to January 2018.	
DEC 2015 – MAR 2016	Issues around cost transparency could also emerge in the context of the European Commission Retail Financial Services and Insurance Green Paper

IMPACT ON CLIENTS, AND BLACKROCK VIEW

Initiatives from the UK and EU aim to increase transparency on the total cost of investing.[7] This is welcome as it will help investors to compare the relative cost and performance of competing investment products and investment services, such as investment advice and discretionary management.

Regulatory guidance should be as specific as possible to ensure all product types and distribution channels report costs on the same way. Figures should be derived from the same building blocks in order to deliver a consistent approach, allowing meaningful comparability between providers.

We recommend reporting on transaction costs in the context of the risk and return delivered by the product and / or service with performance shown after deduction of transaction costs. Given the complexity of transaction cost analysis, BlackRock recommends use of a standardised process to avoid the moral hazard of reporting using different models.

The proposed EU methodology for calculating the total cost disclosure includes explicit costs as well as implicit costs, such as the impact of a trade on market pricing. We have recommended reporting on explicit costs, namely commissions and taxes, for equities and instruments where costs are explicit and using standardised models for fixed income and other OTC instruments where costs are embedded in the quoted price. From the various options available, we recommend using the model used by the Dutch Pension Federation and enhancing this framework by including additional asset classes.[8] Portfolio turnover rates presented in the context of performance can provide an additional useful objective measure. Delivering meaningful transaction costs data to investors, especially in respect of impact costs relies on building large sets of historic standardised trading history to underpin reliable and consistent models. This will be an iterative process as the industry collectively develops consistent quantitative methods of providing this data.

Key features

UK Financial Conduct Authority (FCA) and Department for Work and Pensions (DWP)

The Pensions Act 2014 places a duty on the FCA and DWP to require the disclosure of transaction costs and administration charges. In May 2015, a joint FCA and DWP consultation explored:

- What transaction costs should be reported, including:
  - Entry / exit charges, direct trading costs, indirect charges such as the ‘spread’ between the cost of buying and selling a security, stock lending and non-cash costs.
  - How those costs and any other factors should be captured and reported
  - When, how and in what format cost information should be provided

PRIIPs

- The PRIIPs KID Regulation set out the rules for the content, format, review and timing of delivery of the KID.
- The implementing measures or RTS will include methodologies and presentation of key components such as risk, return and costs.

MiFID II

- MiFID II requires additional cost disclosure at the point of sale and on an ex-post basis, for all products sold to an EU investor, if that product has had a ‘MiFID service’ applied to it.
- MiFID services include portfolio management, execution, advice, receipt and transmission of orders.
- Cost disclosures will be covered in the Delegated Acts, expected by early 2016.

A patchwork of national retail distribution reviews to implement MiFID II

IMPACT ON:	Retail investors, distributors, manufacturers
Present – 2018 (mostly throughout 2016)	Apart from the early movers, UK (2013) and Netherlands (2013 / 2014), change in Member States' retail distribution regime are expected to be included as part of their national implementation of MiFID II.

A PATCHWORK OF NATIONAL RETAIL DISTRIBUTION REVIEWS TO IMPLEMENT MIFID II

EARLY MOVERS	
United Kingdom	The Retail Distribution Review, implemented in 2012, included qualifications for financial advisers and a ban on commissions between product providers and fund distributors on new business, forcing advisers to adopt fee-based models to replace revenue streams. The ban will be extended to discretionary portfolio managers with the introduction of MiFID II.
Netherlands	A ban on payment of commission for mortgage credit, income insurances, unit-linked insurances, annuities and non-life insurances took effect in January 2013. An inducement ban in respect of investment services to retail came into force on 1 January 2014. The Dutch legislator has proposed to extend the ban to commission for offering of unit-linked life insurance products – this is likely to kick in January 2016.
ACTIVE ADOPTERS	
Sweden	Sweden has consulted widely on implementing a commission ban across all products, unless no negative effect can be shown. This is going further than MiFID II.
Denmark	Reviewing the impact of implementation of RDR in the UK, Netherlands and Sweden before planning further changes to the Danish market.
FOCUS ON PROMOTING INDEPENDENT ADVISERS AS A COMPETING BUSINESS MODEL	
Germany	The Facilitation and Regulation of Fee-based Investment Advice Act (August 2014) introduced a legal framework for fee-based investment advice in financial instruments which can be offered by investment services enterprises. This is in addition to ordinary MiFID investment advice based on the disclosure of any commissions received by advisers from issuers of financial instruments or intermediaries. Recent announcements of loosening up on the record keeping requirements on suitability. Other changes tied to MiFID II implementation.
France	France supports a ban on payment of commissions for discretionary portfolio management and has for many years banned commission payments to managers of funds of funds. Many concerns regarding the effect on access to advice raised by too strict an interpretation of the quality enhancement rules.
Italy	The Italian market moves to a dual system of fee-based and commission-based advisers. A commission ban on discretionary, managed fund platforms receiving commission has been in place since the introduction of MiFID I.
Belgium	Unlikely to move beyond MiFID II. Key focus is on banning unsuitable products and ensuring distributors apply more stringent suitability tests.

BOX 2: OVERVIEW OF SWISS LEGISLATION IMPACTING ASSET MANAGERS AND THEIR CLIENTS

Informal alignment with core EU regulation is emerging in Swiss legislation affecting the asset management industry, albeit with differences reflecting local market dynamics.

FinfraG: The 'Swiss EMIR'

The Financial Markets Infrastructure Act, commonly known as FinfraG, reflects the G20 objective of reforming OTC derivatives trading, and is equivalent to EMIR in the EU.

- The Act concerns the standardisation, central clearing, exchange or electronic platform trading, and reporting of OTC derivatives transactions to trade repositories, reflecting developments in financial markets, and new standards developed by international bodies.
- While thresholds used to classify different types of counterparty have not yet been determined, they are likely to reflect those in the US Dodd-Frank Act and EMIR.
- In contrast to the dual-sided reporting required by EMIR in the EU, single-sided reporting of all trades by one counterparty is expected for FinfraG, according to set rules which place most reporting on large financial counterparties. We believe this will lead to more efficient reporting and avoid the reconciliation issues linked to double-sided reporting.
- **TIMELINE**: FinfraG is expected to come into effect beginning of 2016.

Swiss Financial Services Regulation: New drafts less strict, with further divergence from MiFID II

The key tenets of MiFID II are reflected in the Financial Services Act (FinSA), regulating activities, and the Financial Institutions Act (FinIA), regulating institutions. In November 2015, the Federal Council released revised drafts, due for debate by the Swiss Parliament in 2016. Key features include:

- **Level playing field:** The FinSA treats all financial instruments on the same basis, removing previous emphasis on funds and structured products. It therefore involves sweeping amendments to the Collective Investments Schemes Act (CISA) and subsidiary legislation.
- **Newly regulated Financial Services Providers (FSPs):** FinSA regulates all asset managers that have the power to make discretionary investment decisions on behalf of their client, or otherwise to deal with the client's assets. The emphasis on control over assets broadens the concept of discretionary management. Discretionary managers are divided into "qualified" managers requiring full licensing and supervision by the Swiss Financial Market Supervisory Authority (FINMA), and simple asset managers, to be regulated by a specialist oversight subsidiary of FINMA.
- **Registration and education requirements for client advisers**: Anyone providing advice directly to clients will need to be registered. The only exceptions are advisers working for fully Swiss-supervised FSPs. All client advisers will now need to be appropriately trained, according to standards to be set by self-regulatory bodies.
- **Retrocessions and inducements**: Rather than differentiating independent advisers, the FinSA establishes a broad disclosure obligation for retrocessions, applicable to all FSPs and all activities, prior to the transaction.
- **Suitability and appropriateness**: FinSA introduces a distinction between advice on a full portfolio, which attracts a full suitability analysis, and advice on individual transactions, which requires only a basic appropriateness check of the client's knowledge and experience in relation to the products. A definition for advice on multiple transactions that cover less than the full portfolio is likely to be left to subsidiary regulation.
- FinSA requires an adviser that lacks enough information to perform a suitability or appropriateness check to inform the client, but in contrast to MiFID II, allows the adviser to continue to make recommendations without it.
- **TIMELINE**: The Swiss Financial Services Regulation is due to enter into force in 2017.

BlackRock has engaged with Swiss authorities and responded to several consultations. Our comment letters are available on our website:

- Swiss Federal Office of Justice – revision of company law, March 2015
- Federal Financial Services Act and the Financial Institutions Act, October 2014

Tax initiatives impacting Europe

UK pension tax relief: 'Strengthening the incentive to save'

IMPACT ON:	Individual savings for retirement, and the UK pensions industry (including DC and DB pension funds), employers and asset managers
JUL 2015	HM Treasury (HMT) proposal on pensions tax relief under public consultation
H1 2016	Expecting further changes to be reflected in the Finance Act 2016

IMPACT ON CLIENTS AND BLACKROCK VIEW

The UK Government's public consultation on pension tax relief aims to encourage individuals to take responsibility for their retirement, while ensuring the sustainability of public finances. Options range from a radical move to a 'Taxed-Exempt-Exempt' (TEE) system to less radical changes such as adjusting reliefs within the current system.

BlackRock's recommendations include:

- Provide strong incentives for people to save by maintaining the current 'Exempt, Exempt, Taxed' (EET) basis for pensions but moving to a flat rate of tax relief rebranding tax relief as a government matching contribution
- Continue to use auto-enrolment to ensure that individuals do not simply put their holdings in cash, thus protecting them against the risk of not saving enough, and protecting the real value of their savings from the effects of inflation. We recommend phasing in higher contribution rates using auto-escalation techniques such as 'Save More Tomorrow'
- Convince people that there is a stable pensions system by creating an independent, institutional framework (an Office of Pension Responsibility) to depoliticise the formation and maintenance of savings policy-making, and ensuring continuity. This would complement industry calls for a Savings Minister to coordinate long-term savings policy
- Incentivise employers (companies themselves and their individual managers), so that the workplace remains at the heart of pensions savings, particularly through the use of National Insurance Contribution relief
- Recognise the cultural change required for individuals to take responsibility for their own retirement. Any reform of tax incentives should strengthen, not weaken, the link between pensions and long-term investment

BlackRock's response to the HM Treasury consultation is available on our website.

Key features of HMT proposal

- HM Treasury sets out options ranging from:
  - Taxing pension contributions on the way in (currently tax-free), instead of taxing pension payments at income tax rates on the way out
  - Adjusting tax reliefs within the current system
- The consultation asked:
  - To what extent the complexity of the current system undermines the incentive for individuals to save
  - How the system might be simplified to strengthen the incentive for individuals to save into a pension
  - Whether an alternative system would allow individuals to take greater responsibility for saving for retirement, and plan better for how they use their savings in retirement
  - Whether differential treatment for defined benefit and defined contribution pensions is appropriate
  - What administrative barriers exist to reforming pensions tax, particularly in the context of automatic enrolment
  - How employer pension contributions should be treated under any reform of pensions tax relief
  - How the government can ensure that any reform of pensions tax relief is sustainable

EU Financial Transaction Tax (FTT): A tax on savers

IMPACT ON:	European individual and institutional investors and non-EU investors investing in Europe
FEB 2013	Commission proposal for an FTT under the Enhanced Cooperation Procedure[9]
JUN 2016	Date set by FTT10 as date on which there should be agreement on legislative text
2017(tbc)	Stated implementation date, but this is far from certain

IMPACT ON CLIENTS AND BLACKROCK VIEW

The initial policy objectives behind a pan-EU Financial Transaction Tax were to ensure that financial institutions make a fair and substantial contribution to covering the costs of the 2008 financial crisis and to disincentivise transactions that do not enhance the efficiency of financial markets. Seven / eight years after the crisis, an EU FTT is still on the table between the now-10 Member States in favour of an FTT zone – with the policy objective shifting to financing climate change as part of the momentum around the Paris Convention on Climate Change.

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

As it stands in the European Commission's proposal, end-investors will be hit directly because of the cost of the FTT on the transactions undertaken in their portfolios, and indirectly because the 'trading spread' will increase. If the FTT applies to client redemptions from pooled investment vehicles, the FTT will breach the principle that investing via investment funds should be tax-neutral compared to direct investment in the underlying fund assets. We are hopeful the 10 pro-FTT Member States will agree to exempt transitions in fund units in recognition of this.

Key features of EU-FTT

- The now-10 pro-FTT Member States are: Austria, Belgium, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain. Estonia pulled out from the Enhanced Cooperation Procedure in December 2015.
- Financial institutions based in the 'FTT-zone' (residence principle) are taxable on any transactions they carry out (both the purchase and sale of shares and bonds, as well as derivatives contracts)
- Financial institutions domiciled outside the zone are chargeable when they trade with a party based in the zone or on an instrument issued in the zone (issuance principle).
- All securities in scope on each leg of a transaction: Equities and Bonds chargeable at 10 bps; Derivatives chargeable at 1bp, but corresponding physical hedges, collateral movements carry the full 10 bps charge
- No relief for the intermediaries involved in the transaction chain.
- France and Italy implemented a domestic FTT in 2013. The pan-EU FTT will supersede national FTTs, once implemented.

Base Erosion and Profit Shifting (BEPS): Double taxation of cross-border funds and investors?

IMPACT ON:	Primarily multinational companies, but also cross-border funds and cross-border investors.
OCT 2015	Final OECD BEPS package released (Actions 1 to 14)
Early 2016	G20 nations and OECD member jurisdictions, including the EU, to agree on a monitoring framework for BEPS – early 2016, cooperation is foreseen until end 2020
JUN 2016	The EC has committed in its Tax Action Plan (published in June 2015) to implement BEPS within 12 months, which seems quite ambitious. A proposal for a Directive implementing a number of BEPS actions is expected to be published on 27 January 2016
End of 2016	Finalisation of Action 15 on the Multilateral Instrument

IMPACT ON CLIENTS AND BLACKROCK VIEW

The BEPS is a global initiative run by the Organisation for Economic Co-operation and Development (OECD) and the G20. Its original purpose was twofold: curb double non-taxation or tax avoidance by multinational companies, and not create new rules that result in double taxation. The final OECD proposals of October 2015 in practice cast much wider and impact cross-border investors and cross-border funds.

Pooled funds always seek to achieve a tax-neutral outcome, so that their investors are taxed on a basis comparable to direct investment (e.g., via a separate account) in the underlying assets. If they face an additional tax burden over direct investment, pooled funds will become unattractive. The OECD and governments have recognised the potential damage if that happens, and proposed a partial solution.[10] BlackRock recommends a more holistic solution in that countries implement the OECD's Treaty Relief and Compliance Enhancement framework to allow authorities to appropriately tax mainstream funds (UCITS, in a European context), and thereby avoid double taxation.

Alternative funds, especially those investing in infrastructure, renewable energy, real estate, venture capital and private equity are particularly likely to be deprived of the bilateral arrangements that would have allowed them to be relieved from double taxation. With no treaty relief, alternative funds will be unviable for smaller investors (such as mid-sized pension funds and retail investors), who use pooled vehicles (rather than direct investment) to get access to these asset classes. Alternative funds may often be more broadly impacted by the BEPS Action plans (for example, Action 4 covering interest deductions for leveraged financing). We expect elements of BEPS to be written into European law in the course of 2016.

We suggest that the OECD and governments work with the industry to provide a model as to how funds, especially alternative funds, and their investors can appropriately be treated in a post-BEPS world without impairing cross-border investment.

BlackRock published a *ViewPoint* BEPS: Eliminate Double Non-Taxation Without Impeding Cross-Border Investment, describing the impact the OECD initiative can have on both mainstream and alternative funds.

It is also worth noting that the EU will be particularly impacted by the BEPS initative. The success of regional initiatives we have described in this *ViewPoint,* such as ELTIF and EFSI, risks being diminished should countries not find a viable solution to address the BEPS tax framework of these Funds.

Key features of BEPS

- BEPS consists of 15 Actions / workstreams to equip governments with the domestic and international instruments needed to implement BEPS
- Action 15 (multilateral instrument) is the only outstanding workstream
- The Action most relevant to mainstream funds is Action 6 (treaty relief)
- Alternative funds may additionally be impacted by Action 2 (hybrid mismatches), Action 4 (interest deductions) and Action 7 (permanent establishment)
- Governments have until the end of 2016 to implement the final BEPS package

Other relevant tax transparency initiatives: FATCA, UK CDOT FATCA-like regime and CRS

Foreign Account Tax Compliance Act (FATCA)

- The FATCA came into force in 2014.
- It aims to improve information reporting on US taxpayers to prevent tax evasion, and requires Foreign Financial Institutions (FFIs), such as local banks, asset managers, fund distributors, fund administrators and collective investment vehicles, to identify and declare US account holders, and withhold on certain payments to the Internal Revenue Service (the US agency).
- It catches financial institutions that are required to report, including most non-US pooled funds, and some institutional investors too (although pension funds and sovereign wealth funds are usually exempted).

OECD Common Reporting Standards

- In 2013, the G20 identified the prevention of offshore tax evasion as a high priority, and the analysis of high volume, automatically exchanged information about offshore financial assets as the best way to do this. The OECD was mandated to urgently develop such a system based on the US FATCA model.
- The first phase of CRS goes live on 1 January 2016 for the 56 ‘early adopter’ jurisdictions with a second wave of 38 countries joining from 1 January 2017.
- Impact:
  - Investors based in Europe and in other countries can expect their investments to be reported to their home tax authorities.
  - Further tax self-certification documentation will be required from investors in many circumstances.

UK Crown Dependencies and Overseas Territories (CDOTs) rules

- The UK CDOT countries (such as the British Virgin Islands, Bermuda, the Cayman Islands, Gibraltar, Guernsey, the Isle of Man and Jersey) have entered into intra-governmental agreement with the UK to provide information about holders to the UK authorities.
- These apply to UK entities and to those entities domiciled in the CDOT countries.
- CDOT will be phased out as soon as the OECD Common Reporting Standards system enters into force.

Conclusion

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

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

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

RELATED CONTENT

ViewPoint – BEPS: Eliminate Double Non-Taxation Without Impeding Cross-Border Investment (Feb. 2015)

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

Buyside Letter – ESMA Draft MiFIR RTS - Fixed Income Liquidity: Recommendations to Protect End-Investors and Preserve Market Efficiency (Feb. 2015)

Comment Letter – ESMA MiFID II / MiFIR (Mar. 2015)

Comment Letter – European Commission Building a Capital Markets Union Green Paper (May 2015)

Buyside CEO Letter – CCP Resilience, Recovery and Resolution (Jul. 2015)

Comment Letter – EBA, ESMA, EIOPA Risk, Performance Scenarios and Cost Disclosures In Key Information Documents for Packaged Retail and Insurance-based Investment Products (Aug. 2015)

Comment Letter – HMT Strengthening the Incentive to Save: a Consultation on Pensions Tax Relief (Sep. 2015)

ViewPoint – Infrastructure Investment: Birding the Gap Between Public and Investor Needs (Nov. 2015)

FOR MORE INFORMATION

For access to our full collection of public policy commentaries, including the *ViewPoint* series and comment letters to regulators, please visit http://www2.blackrock.com/global/home/PublicPolicy/PublicPolicyhome/index.htm

Endnotes

1 Speech given by Commissioner Jonathan Hill at the 2015 ECMI Annual Conference, "Europe's Capital Markets Union: What is the 'long-term- view?", 22 Oct. 2015. Available at: http://europa.eu/rapid/press-release_SPEECH-15-5870_en.htm

2 IOSCO, "Principles for Financial Benchmarks", Jul. 2013. Available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf

3 A "price maker" is a market participant that expresses a price at which he or she is willing to buy (or sell) a particular security at a given time. To be clear, being a "price maker" is not the same as being a "market maker".

4 CPSS-IOSCO, "Principles for financial market infrastructures", Apr. 2012. Available at: http://www.bis.org/cpmi/publ/d101a.pdf We expect further work on the global principles in 2016.

5 BlackRock's response to ESMA Discussion Paper on Central Securities Depositories Regulation is available at: http://www.blackrock.com/corporate/en-us/literature/publication/central-securities-depositories-regulation-esma-052214.pdf

6 ICMA, "ICMA Impact Study for CSDR Mandatory Buy-ins", Feb. 2015. Available at: http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/short-term-markets/Repo-Markets/icma-european-repo-market-reports-and-white-papers/csdr-mandatory-buy-ins-and-the-treatment-of-sfts-an-icma-erc-briefing-note/

7 In September, BlackRock also responded to IOSCO's global consultation on 'Elements of International Regulatory Standards on Fees and Expenses of Investment Funds', which sought to determine whether the recommendations made in the IOSCO 2004 paper on International Regulatory Standards on Fees and Expenses of Investment Funds are still valid. Issues concern: types of permitted fees and expenses; performance-related fees; disclosure; transaction costs; and hard and soft commissions on transactions. Our response is available at: http://www.blackrock.com/corporate/en-us/literature/publication/international-regulatory-standards-on-fees-and-expenses-of-investment-funds-230915.pdf

8 The Dutch Pension Federation model includes only explicit costs for commission-based products. This methodology provides transparency and objectivity in the client reporting and builds on existing Level 2 disclosure requirements currently in place.

9 The Enhanced Cooperation Procedure is a mechanism enabling a group of Member States to move forward with a legislative proposal despite the lack of consensus among the 28 Member States. It can be carried out under 3 conditions, including that the proposal must not impinge unduly on the other countries.

10 OECD/G20 Base Erosion and Profit Shifting Project, "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances. Action 6: 2015 Final Report". Available at: http://www.oecd-ilibrary.org/docserver/download/2315331e.pdf?expires=1449840188&id=id&accname=guest&checksum=FEC140FCE4DDFE05F9E68AEAB778979F

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