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Finance for your clients: Harmonisation of Capital Markets

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Consolidated Report

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1. Introduction

In the 'post financial crisis' era, companies of all sizes continue to struggle to obtain finance. Although companies have tended to rely on their domestic markets when seeking financing, we are now seeing a more complex structure of financial products being offered by complex, multi-country networks of institutions.

The current regulatory tendency is to foster harmonisation and improve transparency in cross-border transactions to restore investor confidence. Regulators worldwide aim to lower the cost of financing through further capital markets integration. Initiatives to remove barriers to cross-border investments, measures aimed to foster harmonisation and improve transparency in cross-border transactions, diversifying the funding of the economy and reducing the cost of raising capital, have been identified and analysed by our national reporters.

A total of 11 national reports have been submitted, namely: Argentina, Finland, Germany, Hungary, Ireland, Japan, the Netherlands, Spain, Switzerland, Turkey and the United Kingdom. We thank all national reporters for their contributions.

2. Finance for your clients: Harmonisation of Capital Markets

2.1 Integration of the capital markets at the infra-national, national and supra-national levels

The level of integration of capital markets of the European jurisdictions surveyed is very high as a result of many years of regular alignment of national legal frameworks. Currently, integration efforts are focussing on two major areas: firstly, the consolidation of capital markets (e.g., Action Plan on Capital Markets Union, MIFID I/II) and secondly, the strengthening of market supervision and protection from abuse and manipulation (e.g., MAR, CRR). Despite general legal alignment on the European level, our European reporters continue to see some differences between countries due to variances in implementation at the national level so, in 2016, differences in law can still be found, but these are fewer than ever before.

Notwithstanding the above, practical hindrances within Europe continue to exist when it comes to supranational capital transfers. Great Britain, for example, is part of the European Union but does not use the Euro which results in exchange rate fluctuations with its associated risks and difficulties.

Other European countries have also adopted their own policies to harmonize markets outside of EU initiatives.

Finland, for example, co-operates extensively with other Nordic and Baltic countries in matters such as stability, integration and infrastructure of the capital markets.

Although they are not part of the European Union, both Switzerland and Turkey are implementing legislation in order to ensure their individual financial market infrastructures, institutions and service providers compete and synchronise with the European capital markets. The Capital Markets Board of Turkey has moved to integrate the Turkish capital markets with the European capital markets and is in negotiations with the EU on a wide range of matters, including free movement of capital, company law and financial services.

In 2016, Swiss capital markets regulation underwent the most important revision since the Federal Act on Stock Exchanges and Securities Trading (SESTA) was enacted in 1995 with the entry into force of the Financial Market Infrastructure Act (FMIA) and its implementing ordinance, the Financial Market Infrastructure Ordinance (FMIO). In an attempt to implement rules that were consistent with the current international standards, the FMIA and FMIO updated regulatory requirements for the operation of stock exchanges, multilateral trading facilities, central counterparties, central securities depositories, transaction registers and payment systems which, in large part, mimic EU regulations such as EMIR. The new rules also regulate the recognition of foreign financial market infrastructures. In addition, they set out all rules that apply in connection with trading in securities and, for the first time in Switzerland, derivatives for all financial market participants, including criminal and administrative sanctions on insider trading and market manipulation.

In 2012, Argentina passed new securities laws to modify the public offer regime (i) to integrate capital markets at a national level using technology to connect the various markets and (ii) to promote the creation of new stock exchanges around Argentina. Notwithstanding these changes, securities continue to be mostly traded through the Mercado de Valores S.A., the Buenos Aires Stock Exchange, and the Mercado Abierto Electrónico S.A. (MAE), an over-the-counter market.

In Japan, the level of integration of the capital markets is at the national level only, although historically speaking securities laws in Japan have been deeply influenced and affected by U.S. securities laws.

2.2 Access to finance by small and medium sized enterprises ("SMEs")

The approach of the legislature and other governing bodies of the analysed jurisdictions with regards to measures aimed at increasing access to finance for SMEs seems to be quite different.

On the one hand, Argentina has passed new securities laws to promote SME access to the capital market and updated the corresponding regulatory framework for SMEs by lowering the information requirements for SMEs and simplifying the procedures to obtain public offer authorizations.

On the other hand, Finland has taken a more interventionist approach by giving the Finish export credit agency greater authority to grant finance to SMEs with more capital and increased periods of maturity. It also granted the Finnish export

credit agency the power to issue guarantees to SMEs and to purchase debt issued by SMEs.

The Financial System Council of Japan created a working group which, in 2013, recommended an array of measures which are in the process of being implemented, including a proposal to facilitate and boost crowd-funding and other forms of alternative finance. Other measures being developed include facilitating IPOs by SMEs by relaxing listing requirements and other administrative burdens.

In the Netherlands, we have seen the Dutch government acting as guarantor for both loans and equity capital of enterprises via different initiatives.

Spain has recently passed a new piece of legislation amending corporate debt finance, suppressing quantitative limitations for companies and relaxing certain formalities for the approval and execution of debt issuance. A new regulatory framework for the promotion of alternative finance has also been created.

In the UK we have observed the development of a fast-growing alternative finance industry which allows SMEs to pitch to "crowd-sourced" investors to raise equity financing for their businesses. With the growth of these alternative financing mechanisms, in 2014 the UK Financial Conduct Authority began regulating the sector more closely. In addition, public–private venture capital funds have been set up in order to provide equity finance to early stage companies. SMEs have also been provided with several tax relief schemes and consultations are currently taking place on a new strategy for the UK's digital communications infrastructure to support the emergence of new sectors like FinTech.

Ireland has adopted various strategies to lower information barriers and requirements for SMEs. For example, the Irish government provides state guarantees to lenders on eligible loans to SMEs and state loans to start-up, newly established or growing micro-enterprises employing fewer than 10 people, with viable business propositions that do not meet the conventional risk criteria applied by banks.

In contrast, in jurisdictions such as Germany, the main focus of developments has been on the improvement of investor protection, rather than facilitating funding for SMEs. In Hungary and Turkey, no significant developments were identified by our reporters.

2.3 Breaking down barriers to cross-border investment

In the last few years, Argentina has not adopted any specific measures to remove barriers to cross-border investment.

Germany, in common with the rest of the EU countries, has been following the European Commission initiatives to improve marketing infrastructure, to foster convergence of insolvency proceedings, to identify and remove cross-border tax barriers and to facilitate and strengthen supervisory convergence.

The Netherlands has publicly and firmly expressed its support for the Capital Markets Union (CMU) proposals by the European Commission.

Moreover, further action is required in other areas such as the issuance of guidelines and recommendations for the settlement of disagreements between national competent authorities in cross border situations and the establishment of a framework for the recovery and resolution of central counterparties.

Many of the jurisdictions analysed, particularly in Europe, have made efforts to harmonise their insolvency regulation with that of the neighbouring countries.

In this regard, Finland is improving the compatibility of its domestic insolvency legislation with the European Union level capital markets regulation. The Finnish Financial Collateral Act was recently amended to clarify and harmonise the scope of eligible financial collateral.

Likewise, in Ireland, the Personal Insolvency Act introduced three new debt resolution mechanisms to help mortgage-holders and other people with unsustainable debt to reach agreements with their creditors. Under the new legislation, a debtor may, in some cases, gain the same protection against creditors in other EU countries that they would receive in Ireland.

In early 2015 Hungary started to review its insolvency legislation with the aim of developing a new insolvency regime. A report identifying several shortcomings of the existing legislation including procedural matters and creditor rights, was issued. In spite of the report’s findings no amendments to the current legislation have been passed.

As results of the issuance of an Act on Recognition and Assistance in Foreign Insolvency Proceedings, Japanese courts may now approve foreign insolvency proceedings and issue orders to support approved foreign insolvency proceedings.

2.4 Increasing choice and competition in cross-border retail financial services and/or insurance

We asked our National Reporters whether any specific measures had been adopted or were foreseen in their respective jurisdictions in order to boost competition in cross-border retail financial services and insurance.

EU jurisdictions such as Finland, Germany, Hungary, Ireland, the Netherlands, Spain and the UK are relying on the implementation of the BCD, MIFID and AIFMD directives at European Level which allow for “passporting” procedures under much of the European financial services legislation. There have not been any specific measures seeking to increase choice and competition on a cross-border basis outside the European Union, making it very difficult for service providers located outside the European Union to operate in these jurisdictions. Turkey has initiated preliminary initiatives to align itself with the European member states.

In contrast, Switzerland remains open and accessible to foreign retail service and insurance providers. Japan and Argentina have adopted no specific measures to increase choice and competition in cross-border retail financial services and/or insurance.

2.5 Non-traditional sources of financing

Bank financing continues to be the main source of money for SMEs in our surveyed jurisdictions particularly in Hungary, Ireland, the Netherlands, Switzerland and Turkey. However, some of our reporters indicated that sources of alternative forms of finance are growing for companies in certain sectors or are more prevalently used at certain stages of a company's growth.

As indicated in section 2.2, the United Kingdom has experienced the most significant growth of alternative financing. The non-bank lending market is continually developing and the proliferation of non-bank lenders been one of the most striking developments since the financial crisis began. Many non-bank lenders have entered the mid-market with the global search for yield continuing. More than 60% of UK businesses in the mid-market now use non-bank lending as a source of finance.

Governments are stepping up in many jurisdictions to assist SMEs. In Ireland the Department of Jobs, Enterprise and Innovation offers targeted support where there are market failures particularly to ensure that credit is available to fund SMEs during the re-structuring and down-sizing programme for the domestic banking sector. Another example identified in the Netherlands is Qredits, a private, non-profit foundation (partly financed by the Ministry of Economic Affairs) which provides financing of up to EUR250,000 to start-ups and existing business owners from all levels of society. In Turkey, government and quasi-governmental bodies (including international organisations, professional associations, employer associations and universities) are important sources of funds for SMEs.

In Finland, Germany, Spain and the United Kingdom, crowdfunding provides a small but growing component of corporate financing (although recent regulatory changes in Germany may slow that growth).

Reporters indicated that private equity providers and venture capital funds are also players in the financing of SMEs in Argentina, Germany, Spain and the United Kingdom. In Spain, a 2014 study revealed that venture capital activity had recovered significantly with the number of new firms registering and the amount of funds raised from investors at its highest since 2008.

Other more traditional sources of financing such as factoring and leasing remain prevalent in Germany and Japan.

2.6 Financial institutional investment in capital markets

Financial institutions in all of our surveyed jurisdictions, other than Hungary, Spain and Switzerland, have significant investments in the capital markets.

In Argentina, the most significant financial players in the capital markets are insurance companies which were obliged by the former government to invest in bonds and equity.

According to the latest report by the Bank of Finland (2014), Finnish financial institutions had approximately EUR78 billion worth of securities investments in total, an increase of approximately EUR5 billion from the previous period. Some 85% of this EUR78 billion consisted of debt securities. Investments in bonds and equity securities have increased substantially in recent years.

In Germany, 2015 statistics indicate that financial institutions have significant investment in the capital markets, with bonds amounting to close to EUR1,351 billion and shares (including investment certificates and other securities) amounting to close to EUR208 billion.

Financial institutions in Japan invest highly in the capital markets. Japanese government bonds (JGBs), corporate bonds and equity investments are a significant proportion of the assets of financial institutions in Japan. Most of such investments in the capital markets are debt investment and JGBs are more than half of such debt investment. Equity investments by Japanese financial institutions are mainly restricted to ownership of shares issued by other financial institutions due to historical practice and regulatory prohibitions against involvement in non-finance related business.

In the Netherlands, capital market investments by financial institutions have generated debate, as banks (in the past) have made controversial purchases (e.g., shares in the arms and nuclear industries). These investments are considered by many to be in conflict with the corporate and social responsibilities of the banks, which has led to the creation of new Dutch banks (e.g., Triodos and ASN) that focus on "socially responsible" lending and savings operations.

2.7 Availability of SME credit information

Increasing the availability of SME credit information is an important step to improving the ability of investors to invest in SME. As a result, we thought it useful to ask our national reporters to provide an update on the accessibility of credit information on SMEs in their jurisdictions.

According to our findings, none of the jurisdictions analysed have easy and ready available SME credit information for investors. Nonetheless, the level of availability of information differs amongst them.

While in Argentina, Hungary, Japan, and Turkey it is difficult for investors to obtain such information, in jurisdictions such as Finland, Germany, the Netherlands, Spain and Switzerland, investors can rely on information provided by private credit reporting agencies.

In the UK, legislation was enacted in 2015 that imposes a duty on certain banks to provide information about their SME customers to designated credit reference

agencies ("**CRAs**"), and a duty, in turn, on the CRAs to provide credit information about SME businesses to finance providers.

The Bank of Finland has established a credit database that will collect SME credit information from 2017. Ireland has established a central credit registry owned by the Irish Central Bank which aims to provide financial data in relation to SME credit thereby giving more informed decision-making to lenders. In the Netherlands, the Ministry of Economic Affairs has recently launched a pilot program that operates as an on-line portal where SMEs can freely submit their information based on standardised forms.

2.8 Measures related to Securisation

The European Union has proposed regulation that will apply to all aspects of securitisation, including due diligence, risk retention and transparency rules together with criteria to identify simple, transparent and standardised ("**STS**") securitisations. There is also a proposal to amend the Capital Requirements Regulation ("**CRR**") in order to make the capital treatment of securitisations for banks and investment firms more risk-sensitive and to reflect properly the specific features of STS securitisations. The proposed measures include the following: if loan and mortgage portfolios are transformed into tradeable securities, they must be divided into different risk categories; the owner of the loans must also be the owner of the securities; only loans with the same high lending standards may be packaged; no re-securitisation (no CDO-squared) will be permitted; and banks involved in the securitisation must keep at least 5% of the total amount securitised.

Reporters from Argentina, Finland, Hungary, Ireland, Japan and the Netherlands reported that their jurisdictions do not have existing legislative frameworks tailored specifically for securitisation. In contrast, there have been significant legislative developments in Turkey over the past two years to establish a securitisation framework.

Even in those jurisdictions without securitisation legal regimes, securitisation does occur. For example, in Finland, the rules on re-characterisation facilitate the use of structures which, absent a true sale judgment, will nonetheless be upheld as secured lending transactions. In Hungary, a draft law on securitisation was prepared but never implemented in the mid-2000s. Although securitisation is feasible under existing Hungarian law, investors continue to face two problems: (a) purchasing receivables and servicing underlying debt are licensable activities (and thus a licensed intermediary is usually imposed in the structure to purchase the receivables first from the Hungarian originator); and (b) Hungarian laws do not regulate SPVs as special types of entities and therefore bankruptcy-remoteness and ring-fencing is always a complex structural and contractual issue.

In the Netherlands, industry players are working together outside the legislative framework to facilitate the growth of the securitisation sector. In October 2012,

the Dutch Securitisation Association was established with the aim of promoting the interests of both issuers of, and investors in, Dutch securitisation transactions. Among its members are ABN AMRO Bank, ING Bank and SNS Bank. Its ultimate objective is to create a healthy and well-functioning market for Dutch securitisation transactions, by developing a standard for Dutch securitisation transactions both in respect of documentation and investor reporting.

3. Recommendations and Predictions for the Future

We asked each of our reporters to indicate, based on their experience, where changes in the regulation of capital markets were needed and/or expected.

In Argentina, the government has indicated that the capital markets regime as a whole would be reviewed and revised to meet international standards. It is expected that derivatives regulation will be a significant area of focus as regulation in this area is almost non-existent.

In Finland, the recent number of overhauls of the regulatory regime is causing concern due to the lack of legal precedents and doctrine.

Our German reporter identified conflicts between EU regulation and German law which practically restrict the ability of listed companies to undertake capital increases of less than EUR1 million.

In Hungary, laws that impose unnecessary licensing make cross-border lending transactions very difficult. The problem is not with the requirement that a lender needs a licence but the scope of the definition of "lending", which includes the arrangement of a loan and the debt collection/taking security, even if the security agent is not a lender of record.

Our Irish reporter indicated that while Ireland is ranked high internationally in terms of ease of doing business, the burden of regulatory compliance is not spread proportionately across companies of different sizes. Compliance costs fall as business size increases and the disproportionate cost of compliance is the primary issue affecting the smaller businesses.

In Japan, it is generally agreed among practice lawyers that "border lines" as to whether certain financial regulations are applicable or not are not clear. For example, the scope of extra-territorial application of Japanese financial regulations is not explicitly addressed in the applicable financial regulations and is, thus, subject to interpretation. Another example is that it is not clear which activities fall under the scope of "solicitation" and which trigger disclosure regulations, license requirement or other regulations.

Our Dutch and UK reporters identified problems with existing EU regulations that have unintentionally created barriers to a truly single EU market. For example, the passporting regime, which is intended to facilitate cross-European capital raising, also allows EU member states to impose additional requirements (or "gold plate" the requirements). As a result, it is sometimes unclear to foreign

clients whether they can freely operate cross-border under a true capital markets union or whether they require also require a domestic license. In practice, this can lead to "exotic" structures, which is contrary to the spirit of the capital markets union. Furthermore, it was suggested that undue reliance on somewhat unclear ad conflicting guidance published by European Supervisory Authorities (ESAs) on the interpretation of European law has led to regulatory arbitrage across Europe.

It was argued that there is room in Spain for changes to corporate governance rules affecting companies listed on securities exchanges. For certain companies (including SMEs) our reporters suggest that corporate governance rules have become an unnecessary (and ineffective) compliance burden.

In Switzerland, the unco-ordinated development of the securities law regime has led to inconsistencies. Now, the Swiss government is attempting to remedy these issues through the Financial Market Infrastructure Act (FMIA) (in force as of January 2016), the Financial Services Act (FinSA) and the Financial Institutions Act. It remains to be seen whether intended and unintended consequences of the new regulations will be beneficial for some or all of the players on the capital markets.

In conclusion, even though all jurisdictions analysed seem to agree on the necessity of further integrating its capital markets and, although some progress has already been made, it seems we are only at the very beginning of a necessary harmonisation process, which should help diversifying the funding of the economy and, thus, ease finance for your clients.

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