The Weekly Report from Brussels, provided by the European Affairs team at the City of London, provides an update on key developments relating to financial services in the EU.

7 April 2017

Welcome to the Weekly Report, prepared by the City of London European Affairs team.

This week includes:

More information about the work of the City of London European Affairs team can be found **here.**

Parliament sets out its requirements for negotiations with the UK

On 5 April, the European Parliament **debated and voted** on a resolution setting out its main conditions for approval of the UK's withdrawal agreement. Following a heated debate, which included contributions from UK MEPs, Parliament strongly backed the resolution by 516 votes in favour to 133 against, with 50 abstentions, clearing the two thirds threshold that group leaders set out to demonstrate a unified position.

Background:

On 29 March, the UK Government formally triggered Article 50 when Sir Tim Barrow, Permanent Representative of the UK to the EU, delivered Prime Minister May's **letter** to Donald Tusk, President of the European Council. In response, the European Parliament published a resolution setting out its positions on the forthcoming negotiations following the UK's formal notification.

The **resolution** argues that the areas which need to be addressed in the exit agreement are:

- The legal status of EU citizens now residing in the UK (and vice-versa), as well as other provisions concerning their rights.
- The settlement of financial obligations between the UK and the EU, as audited by the EU Court of Auditors.
- Border issues between the UK and the EU, relating to Northern Ireland.
- Clarifying the commitments made by the UK whilst a Member State of the EU in international treaties.
- Providing legal certainty for businesses with cross-border operations.
- The designation of the Court of Justice of the European Union as the competent authority for the interpretation and enforcement of the withdrawal agreement.

The resolution also broadly agrees with the approach set out to negotiations by the Council last week, specifically that the negotiations on the terms of the UK's exit must be concluded before any agreement on a future or transitional relationship is concluded and that whilst the negotiations on a future relationship may begin if progress is made on the exit negotiations, an agreement can only be concluded after the UK has become a third-country. It also states that the UK cannot begin negotiations on trade deals with third countries while it is still a Member State and that any attempt to negotiate a bilateral agreement with a Member State separately would go against the Treaties.

Regarding the future arrangement, the resolution rejects proposals for certain UK sectors to remain in the Single Market, specifically singling out the financial services sector, and reiterates that membership of the Single Market will require all of the obligations of membership, including continued oversight by the Court of Justice of the European Union, acceptance of the four freedoms and budget contributions. However, it notes the UK Government's request to continue participating in EU programmes, such as Erasmus and Horizon, and would welcome the UK's continued participation.

Additionally, whilst the resolution calls for as close a future relationship as is possible between the UK and the EU, this would be conditional on the UK not undermining the EU's standards and common efforts in areas such as the environmental standards, climate change, combatting tax evasion and avoidance, fair competition, trade and social policy.

The resolution allows for the possibility of a transitional agreement, but that this should not exceed three years and should be "limited in scope as there can never be a substitute for union membership". It also calls for the relocation of the European Banking Authority (EBA), currently located in London, to begin as soon as soon as is practical and for no cut-off date after which EU nationals coming to the UK lose the automatic right to residency in the UK to be implemented before the UK's exit.

Latest Developments:

During the debate, Guy Verhofstadt MEP (ALDE, Belgium), leader of the ALDE group and Chief Negotiator for the Parliament said that he wants to reach a deep and comprehensive partnership between the UK and the EU, but this would have to be significantly different from Membership. He also expressed sadness that the UK would be leaving the EU, but also predicted that, in the future, a different UK leader will lead the UK back into the EU, and be supported by a younger generation which will recognise the UK leaving the EU as "a catfight (between factions of the Conservative Party) that got out of hand".

Manfred Weber MEP (EPP, Germany), leader of the EPP group, said now that Article 50 has been triggered the European Parliament is ready to begin negotiations, and set out achieving reciprocal rights to remain for EU citizens in the UK (and vice-versa) and finding a suitable solution for Northern Ireland to be the top priorities. He also expressed concern at the way in which this debate is being conducted in the UK, referencing statements from Michael Howard on the possibility of a confrontation with Spain, demonstrates that the debate is being "hijacked by populists and nationalists". He also called for the UK to refrain from involvement in decisions on the EU's future.

Gianni Pittella MEP (S&D, Italy), leader of the S&D group, echoed these concerns regarding the tone of debate from supporters of the UK's withdrawal from the EU. He stressed that the European Parliament will not be threatened by any ultimatum by the UK of using common security as a negotiating chip, and stated that any future agreement will depend on the UK not undercutting EU social and environmental standards, and stating that he doesn't want to see any favourable treatment being given to the City of London in the negotiations.

Helga Stevens MEP (ECR, Belgium), deputy leader of the ECR group, criticised Mr Verhofstadt for not listening to all groups and Committees in the Parliament when creating the Parliament's negotiating position. She argued that the UK will continue to remain one of the EU's main trading and security partners following its withdrawal and so the EU should not set out unnecessary restrictions during the negotiations. Specifically, she highlighted the three year limit on transitional arrangements as arbitrary and should be extended for some issues, and the negotiations should begin discussing the future relationship between the UK and the EU at the start of the two year period. Finally, she called on the Parliament to use this opportunity to create a reformed and decentralised EU.

In response to the resolution Michel Barnier, Chief Negotiator for the European Commission, welcomed the contribution from MEPs, arguing that it was right that the Parliament will play a large role during the negotiations and get the final say on any agreement, as it is the body which represents EU citizens during the process. He called for unity in the negotiations from the 27 Member States, arguing that this would be in everyone's best interests as a disunited union could lead to no agreement being reached, which is in no one's interest, and for negotiations to be carried out in a transparent fashion.

Contributions to the debate were also made by UK MEPs with Ashley Fox MEP (ECR, UK) calling for negotiations on a comprehensive, future relationship to begin as quickly as possible. He called for the rights of citizens to be guaranteed, for the borders between the UK and the EU to be as invisible as possible to allow Free Trade to occur and for the self-determination and sovereignty of Gibraltar to be recognised.

Catherine Bearder MEP (ALDE, UK) asserted that many of the statements made by the Leave campaign during the referendum have now been showed to be false. She argued that the UK electorate should be allowed a say on the final deal and, should the negotiations go badly and people recognise that the UK cannot get a better deal outside of the EU than inside it, they should be able to revoke Article 50.

Nigel Farage MEP (EFDD, UK) stated that the EU's response to the triggering of Article 50 has been predictable and called the series of demands which the Parliament has made to be unreasonable and impossible for the UK to comply with. He disagreed that the UK should have to pay outstanding commitments of £52 billion, as this figure doesn't acknowledge that the UK has made a net contribution of £200 billion to the EU during its time as a Member State. He responded that the EU has shown itself to be vindictive in making these demands, and argues that, if no agreement is reached, it will not be the UK that is harmed, as it can trade with other countries in the world, but it will be workers and businesses in the EU.

Following the debate, MEPs voted strongly in favour of the resolution, with the strongest support from the European Peoples' Party, Socialists & Democrats, Alliance of Liberals and Democrats in Europe, and Greens/European Free Alliance groups. UK MEPs were also entitled to vote on the resolution and all UKIP MEPs and Unionist MEPs from Northern Ireland voted against the motion, whilst Conservative MEPs were split, with roughly half voting against the motion and half abstaining. All other UK MEPs present voted to back the resolution.

New rules for Money Market Funds passed by Parliament

On 5 April, the European Parliament **voted** to approve new rules to Money Market Funds to make them more resistant to crises and market turbulence.

Background:

The In 2013, the Commission proposed a **regulation** for MMFs which would ensure they invest in well-diversified assets and set out common standards to increase their liquidity. There are currently two kinds of MMFs:

- those that offer a variable net asset value (VNAV) that mainly depends on market fluctuations
- those that offer a constant net asset value (CNAV) and aim to offer share purchases and redemptions for a fixed price

CNAV funds generated greater risk during the financial crisis as their share price does not change when markets fall, and the original proposal would have phased out these funds over two years.

In November 2016, the Council and the Parliament reached an **agreement** on the regulation, where most CNAV funds will be phased out, but funds dealing with public debt will be able to continue offering fixed returns. Additionally, a new category of MMFs, Low Volatility Net Asset Value (LVNAV) funds, will be created.

The key features of LVNAV funds are:

- A strict portfolio fluctuation band: the constant NAV cannot deviate by more than 20 basis points from the actual NAV - this is far stricter than the 50 basis points used by CNAVs
- Diversified portfolio with stringent concentration requirements to reduce risk, assets described more precisely and subject to strict conditions
- Limit the use of the amortised accounting method for the valuation of assets
- Strict daily and weekly liquidity requirements to fulfil potential redemption requests

- A stringent regime of fees and gates in case of shortfalls in liquidity, to address the question of 'run risk' and first mover advantage
- Increase transparency to ensure investors and supervisors get better & earlier information.

LVNAV funds were proposed as a transitionary arrangement, but under the agreement these funds will remain in place after CNAV funds are phased out.

Latest Developments:

Speaking before the vote, Neena Gill MEP (S&D, UK) highlighted that the length of time it has taken for the Parliament and Council to reach an agreement on this, over three and a half years, is indicative of how it is one of the most contentious and complex pieces of legislation the Parliament as ever dealt with, but she believes that the compromise reached is one which the Money Market Fund sector can agree with and will contribute to the long-term stability of European Financial Markets.

Valdis Dombrovskis, Commission Vice-President for Financial Stability, Financial Services and Capital Markets Union, welcomed the vote, saying that Money Market Funds were shown during the financial crisis to be vulnerable to market shocks and could amplify these risks, and argued that the agreement strikes a balance between addressing the vulnerabilities of Money Market Funds while maintaining them as a viable product. He argued that this agreement will protect consumers whilst also ensuring that they continue to provide short-term funding to small- and medium-sized enterprises.

Brian Hayes MEP (EPP, Ireland) appreciated the balanced approach which was agreed in the compromise between Parliament and the Council, noting that the Commission's original proposal, which suggested a 3% capital buffer for CNAV funds, would have severely impacted €400 billion worth of domiciled funds in Ireland. He also highlighted that the majority of problems caused by Money Market Funds during the financial crisis occurred in the US, not in the EU.

Next Steps:

Following the debate, Parliament backed the legislation by 549 votes in favour to 179 against, with 9 abstentions. The Council is expected to approve the regulation next week.

MEPs back new rules on Prospectuses

On 5 April, the European Parliament **voted** to approve new rules on securities prospectuses, which aim to contribute to further financial market integration and to improve investor protection in the EU.

Background:

In November 2015, the Commission published a **proposal** for a regulation on the prospectus to be published when securities are offered to the public or admitted to trading. The aims of the regulation are to reduce fragmentation in financial markets in order to make it easier for EU business to obtain funding and to improve protection of investors by giving them shorter, yet detailed and comprehensible information on investment products, to help them decide whether to invest or not.

In December 2016, the Council reached an **agreement** with the Parliament which resolved several disagreements with the regulation. The key features of the regulation are:

- Ensuring that no prospectus will be required for to issues of securities up to €1 million.
- The threshold beyond which a prospectus is mandatory is increased from €5 million to €8 million in capital raised.
- A new type of prospectus, the EU growth prospectus, will be available for SMEs with up to 499 employees;
- A new corporate bond prospectus, previously only for debt issued in denominations of at least €100 000, will be available for admission to wholesale debt markets.
- A frequent issuer regime will be available for frequent participants in capital markets to reduce approval times.
- For secondary issuances, issuers already admitted to stock markets and SME growth markets will benefit from a lighter prospectus for follow-up issuances.
- Setting out the amount of information needed in order to make prospectuses shorter and clearer.
- Paper prospectuses will no longer be required.
- An online prospectus database of all prospectuses approved in the EEA will be operated free of charge by the European Securities and Markets Authority.

Latest Developments:

Speaking before the vote Petr Jezek MEP (ALDE, Czech Republic) said that the changes made by the Economic and Monetary Affairs (ECON) Committee will help to make it less costly for businesses to raise funds publicly, whilst also making the Prospectus Directive more fitting to the current environment. He highlighted the amendments to increase the thresholds under which issuers would benefit from exemptions from the regulations and the creation of a lighter regime which will help facilitate cross-border issuances for smaller companies as changes which make the Prospectus Directive more suited to modern financial services.

Valdis Dombrovskis, Commission Vice-President for Financial Stability, Financial Services and Capital Markets Union, agreed that the regulation is an important step in enabling cross-border investments, providing companies with easier access to capital markets and in delivering better information to investors. All of this, he said, delivers on a key element of the Capital Markets Union Action Plan. He in particular welcomed the establishment of an EU Growth prospectus, which can be used by both SMEs and mid-caps can use this simple prospectus to raise capital on SME Growth Markets.

Brian Hayes MEP (EPP, Ireland) also welcomed the agreement on the new rules, calling them a vital step in making it easier for companies to raise capital within the markets to grow in a sustainable way. He expressed hope that the rules would reduce the EU's overreliance on banking finance, which accounts for 75% of lending in the EU compared to 25% in the US.

Next Steps:

Following the debate, Parliament backed the legislation by 517 votes in favour to 109 against, with 71 abstentions. Once the Council approves the regulation, the rules will come into effect two years afterwards.

In other news

- The European Parliament **voted** to give allow greater budget flexibility through a revision of the multi-annual Financial Framework (MFF)
- The European Parliament **approved** €71.5m in EU aid after natural disasters in UK, Cyprus, Portugal
- The ECON and BUDG Committees held a **debate** on the proposed extension of the European Fund for Startegic Investment (EFSI)
- The PANA Committee held a **debate** on the impact of the Panama Papers in Developing Countries
- The European Parliament held a **debate** on the progress on second review of Greece's Economic Adjustment Programme
- A Eurogroup **meeting** and a **meeting** of the ECOFIN Council took place in Valetta
- AFME has published a **paper** outlining the challenges of Brexit implementation for wholesale banking
- ESMA has issued an **opinion** on the European Commission's Proposal for EU Regulation on CCP Recovery and Resolution
- ESMA has published its **final report** on Technical standards under SFTR and certain amendments to EMIR
- ESMA has published the **responses** to its consultation on future guidelines on the transfer of data between trade repositories
- AMF has published a **professional guide** for asset management companies on the new measures introduced by MiFID II

Upcoming EU Institutions events and consultations

28 April: Deadline for EIOPA **consultation paper** on the Proposal for Guidelines under the Insurance Distribution Directive on Complex Insurance Based Investment Products
5 May: Deadline for EBA **consultation** on RTS on CCP to strengthen fight against financial crime
16 May: Deadline for responses to EBA **consultation** on Guidelines on procedures for complaints of alleged infringements of the PSD2

29 May: Deadline for responses to EBA **consultation** on RTS on the specification of the nature, severity and duration of an economic downturn
2 June: Deadline for responses to EBA **consultation** on the coverage of entities in a group recovery plan
5 June: Deadline for responses to EBA **consultation** on on Guidelines to prevent transfers of funds can be abused for ML and TF

City of London Research

The City of London produces regular research on EU Financial Services which can be accessed **here.**

Contacts - Brussels

Mike Vercnocke
Head of European Affairs
+32 (0)2 282 8457
michael.vercnocke@cityofficebrussels.be

Michael O'Shea
European Policy Advisor
+32 (0)2 282 8456
michael.oshea@cityofficebrussels.be

Tom Jobling
European Policy Assistant
+32 (0)2 282 8455
thomas.jobling@cityofficebrussels.be

Contacts - London

Sarah Murray
European Regulatory Affairs Manager
+44 (0)20 7332 3968
sarah.murray@cityoflondon.gov.uk

Audrey Nelson
Senior European Regulatory Affairs Advisor
+44 (0)20 7332 1054
audrey.nelson@cityoflondon.gov.uk

Maja Erceg
European Regulatory Affairs Advisor
+44 (0)20 7332 1451
maja.erceg@cityoflondon.gov.uk

Our mailing address is:
City of London Corporation
PO Box 270, Guildhall,
London, London EC2P 2EJ
United Kingdom