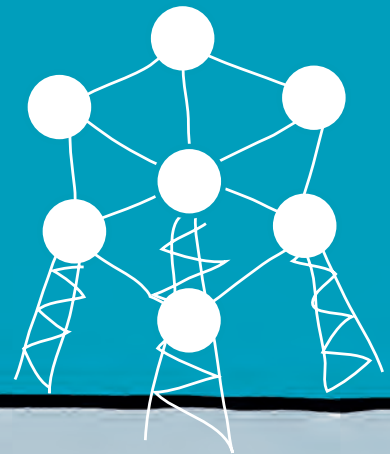


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**RESTARTING
EUROPE!**



RESTARTING EUROPE

MAKING THE MOVE TO SUCCESSFULLY
SUSTAIN IN GLOBAL COMPETITION!



The May elections have delivered results, the new EU Commission is about to take office, and now Europe has to deliver. Solutions are desperately needed for voluminous and pressing challenges. While coping with migration and the hazards of climate change remain Herculean tasks not only from a European perspective, a range of serious developments with lasting economic impacts and consequences for the EU will need to be dealt with.



These stretch from changing transatlantic relations and the continuing rise of China as a superpower to the consequences of the expected Brexit, climate change and disruptive technological developments. There is no time to lose: Commission and Parliament have to resume their work quickly.

Maintaining, strengthening and optimizing the economic capacity of the European Union is essential for Europe not only to sustain but to prevail in a situation dominated by a correlation of the afore-mentioned components. In order to do so, business and politics have to join forces. European policy makers need to understand and reflect on the competitive situation that European companies find themselves in vis-à-vis third country competitors. An open and impartial dialogue between European companies and European regulatory institu-

tions is needed and will create much needed trust.

Companies are the lifeblood of the social market economy in Europe and are capable of providing an essential part of the solutions to the challenges above by creating growth, jobs and technical innovation.

As organization of capital markets-oriented companies, Deutsches Aktieninstitut is deeply committed to creating an environment, which enables companies to unfold their potential for the benefit of the economy and the society alike. From this perspective, a new approach to the EU economic-policy – especially addressing capital markets, the internal market and corporate sustainability – is urgently needed.

The following objectives should be pursued:



1. Build a Capital Markets Union 2.0 – Ensure an unhindered access to corporate finance

Capital markets have a twofold key function for our economy: they enable companies to raise capital for investments into growth, jobs and innovation and at the same time serve private households as an important tool to build wealth, e.g. for retirement savings.

In order to preserve these key functions, the right regulatory balance has to be struck. However, at present, regulation on the supply and demand-side is misaligned. Disproportioned rules on investors protection often impair the needs of issuers. Companies often refrain from entering capital markets due to overwhelming regulatory obstacles, such as transparency rules and compliance costs.

A follow-up on the Commission's Capital Markets Union-Initiative is needed. The present shortcomings should be addressed by a stronger focus on the companies' perspective. The 2014-2019 Commission has identified a simplified access to capital markets for corporate finance-purposes as one of the key-objectives of the Capital Markets Union. This objective needs to be followed. It is therefore essential to improve the current regulatory framework, which does at times deter issuers from using capital markets as a source of finance.

A relief of reporting and compliance duties for companies arising from the application of different EU regulatory frameworks is needed. Many companies are overwhelmed by the sheer amount of and often bureaucratic different legal requirements stemming foremost from EU level. Companies do their best to comply with the many requirements that unfortunately often lack legal clarity. As a study of Deutsches Aktieninstitut on the implementation of the Market Abuse Regulation shows, companies have to seek more and more external legal advice in order to not face severe sanctions in case of non-compliance.¹ As a consequence, the trend continues that companies decide to refrain from entering public markets or delist.

In essence, the following initial steps should be undertaken:

1 CREATE AN EASY AND BARRIER-FREE ACCESS TO CAPITAL MARKETS AND PUBLIC LISTINGS:

a) Simplify and streamline the market abuse-rules (MAR/MAD)

The Market Abuse Regulation and Directive (MAR/MAD) provide a regulatory framework for maintaining market integrity and avoid potential price distortions arising from insider dealing. While we welcome these objectives, it has to be stressed that both rulebooks have produced a considerable level of red tape and legal uncertainties for issuers without clear corresponding benefits for investors.

¹ Deutsches Aktieninstitut (2018): Zwei Jahres EU-Marktmissbrauchsverordnung. Online at: <https://bit.ly/2lGa4Dk>.

Listed companies are still confronted with the fact that central legal definitions remain unclear. This has been shown by a study conducted by Deutsches Aktieninstitut last year.² In addition, despite unclear legal definitions, the sanctioning framework has been increased dramatically. This combination has produced a vast disincentive for companies to enter capital markets.

Moreover, extensive interpretations of MAR-duties by the European Securities Markets Authority (ESMA) have added to the present level of complexity. This combination has exposed listed companies to higher sanctioning risks and less legal certainty at the same time and has produced a situation making public listings less attractive.

Not only small and medium sized companies (SMEs) are hit by this development, but issuers of any size. It is therefore important to reduce bureaucratic burdens in general.

As regards SMEs, an additional issue deserves attention: Typically, SMEs are listed in non-regulated markets. As the scope of application of MAR has been extended to non-regulated markets the complexity of compliance for SMEs has substantially increased. They now have to compile insider lists, notify managers' transactions, and comply with the duty to publish inside information – a serious disincentive for non-listed companies to go public. This stands in sharp contrast to the objectives of the Capital Markets Union aiming at creating diversified sources of corporate finance also for smaller issuers. The scope of application of the market abuse rules beyond regulated markets needs to be reconsidered!

„Issuers of any size are hit by this development. It is therefore important to reduce bureaucratic burdens.“



b) Prospectus Regulation to be tidied up

As regards the Prospectus Regulation, issuers find themselves in a similar situation. While the general aim of the Prospectus Regulation to create transparency for investors is welcome the regulation contains certain imbalances that need to be overcome. As part of the EU Commission's Capital Markets Union project, the revision of the prospectus regime has fallen short of the aim to alleviate issuers from time-consuming and costly drafting and has not contributed to make prospectuses easier to read and to be understood better by investors.

Instead, the revision has not only increased complexity but caused confusion and legal uncertainties for companies. The obligation of a categorization of risk factors as well as the obligation to select out of all potential risks only the fifteen most material risks in the summary should not have been adopted. This rule is capable of triggering serious prospectus liability-cases for issuers as minor risks, which under the present rules are not allowed to be mentioned might materialize in the summary. A wrong categorization or a wrong selection of the most

² Ibid.

material risk factors could be interpreted as misleading presentation triggering liability risks and litigation, thereby making capital markets less attractive and creating unnecessary burdens for companies. A balanced revision of the prospectus summary rules should be targeted.

2 SIMPLIFY AND ALLEVIATE CORPORATE REPORTING

Detailed, inflexible and steadily increasing reporting obligations for listed companies have accumulated over the years and created bureaucratic burdens and disproportionate compliance costs for companies often without corresponding investor benefits. The electronic reporting tool iXBRL subject to the European Single Electronic Format (ESEF) can be seen as an example here as it obliges companies to squeeze their annual reports in a one-size-fits-all template which does not allow a tailor-made report corresponding to a company's business model. Such an approach stands in sharp contrast with advanced reporting techniques such as integrated or value-balanced reporting.

New reporting duties will frequently also produce additional liability risks for companies and act as a disincentive for public listing. Any consideration of new reporting requirements should be based on a thorough impact assessment indicating its necessity. Reporting requirements without any corresponding benefits must be abolished. Against this background the Commission's fitness check of public reporting by companies needs to be adjusted accordingly.

3 CAPITAL MARKETS UNION AS A CROSS-SECTORAL OBJECTIVE

From our point of view, it is essential that the objectives of the Capital Markets Union are constantly and consistently followed cross sector-wise and are not undermined by any European regulatory initiative.

A leading negative example is the proposal to introduce a Financial Transaction Tax (FTT). The Financial Transaction Tax will hamper corporate finance activities and disadvantage private investments into share-based retirement saving-schemes. Efforts of private investors to make up for shortcomings of state- or government pension-plans would hence be punished. The tax would also have a detrimental impact on corporate financing via the stock exchange. Companies need access to capital to compete globally and, above all, to meet the challenges of digitization. The same applies to the presently discussed scope of the FTT in the form of a taxation on the acquisition of shares, as put forward on 7 June 2019.³ Against this background, we urge policy makers once and for all to abandon the idea of a Financial Transaction Tax that threatens to cause considerable damage to the creation of a Capital Markets Union.



³ Council of the European Union (2019): Council Directive implementing enhanced cooperation in the area of financial transaction tax. Online at: <https://bitly/2n9kCes>.

2. Corporate Sustainability and Sustainable Finance

Sustainable Finance has produced a new dimension of the debate on the Capital Markets Union. Originally the Capital Markets Union was intended to overcome the consequences of the past financial crisis by making companies more resilient and creating additional sources of corporate finance in the first place. Sustainable Finance is aimed at a redirection of financial flows to sustainable and especially climate-friendly investments. These objectives do not necessarily supplement but can contradict each other. This should be kept in mind in the legislative debates and processes on Sustainable Finance. Europe needs to strive for the best possible solutions to unite and reconcile the original motivation of the Capital Markets Union with the objectives of Sustainable Finance!

Deutsches Aktieninstitut supports the transition to a low carbon and resource-efficient economy as laid out in the Commission's "Action Plan for Sustainable Growth".⁴ Climate change and environmental pollution remain crucial and pressing challenges affecting all of us. Listed companies throughout Europe and across all industries are well aware of their responsibilities and are willing to make a positive contribution, which is demonstrated by the broad spectrum of voluntary corporate sustainability initiatives among others on climate mitigation and environmental protection. Regulatory initiatives by the European and national regulators should acknowledge and incentivize these voluntary initiatives rather than creating starch and inflexible rules.

„Creating a strong European economy requires to involve companies in the sustainability debate.“

In order to create a strong and sustainable European economy, companies have to be involved in the sustainability debate. It is essential that also company representatives are appointed to Sustainable Finance expert forums such as the yet to be established Platform on Sustainable Finance. Corporate concerns need to be taken seriously as ultimately, companies are the true drivers of sustainability by delivering technical innovation. A healthy competition-environment ensures the development of sophisticated technologies, which are needed to meet sustainability targets.

Regulatory initiatives pursuing climate change mitigation, environmental protection and other sustainability topics should be developed from this perspective and correspond to the following coordinates:

1 TAXONOMY: FLEXIBLE FRAMEWORK AND PRACTICAL GUIDANCE NEEDED

In terms of setting the coordinates for and progressing the Sustainable Finance Taxonomy, which is set to define the degree of sustainability of an economic activity, a flexible rule-based approach should be preferred to starch and misleading one-size-fits-all rules. In order to achieve a positive and climate-relevant impact, it is essential that the

⁴ European Commission (2018): Action Plan – Financing Sustainable Growth. Online at: <https://bit.ly/2LRSUtO>.

Taxonomy has to be set up in a way to support every company of any industry-sector in its endeavour to create its individual sustainable business model. It should especially be taken notice of the fact that switching to a carbon-neutral and sustainable economy cannot be done overnight and often requires the use of transition-technologies or production processes which might partly be regarded as non-sustainable. For example, a long road still needs to be travelled down until fossil energy production is entirely replaced by renewable energy. During the transition phase, gas as a fossil energy source, but less CO₂-intensive than coal, is indispensable. From this perspective, a holistic view on sustainability is needed. A categorical preclusion of certain industries by a “green vs. brown approach” should be rejected.

Up to now, companies are widely left unknown as regards the question of how to apply the Taxonomy in practice. Especially the question of reporting or giving information on the Taxonomy concerns companies at large. A sound guidance is strongly needed here. Furthermore, it has to be closely observed that the Taxonomy maintains a sufficient level of flexibility and does not develop into a ‘bureaucratic monster’. For this reason, a comprehensive field test of the Taxonomy’s practicability should be conducted prior to its entry into force. Such a field-test should involve companies of all industry-sectors and economic sectors which the Taxonomy is deemed to address.

2 FOR A SENSIBLE AND PROPORTIONATE APPROACH IN NON-FINANCIAL REPORTING

Reporting non-financial and climate-related information is becoming increasingly important for companies as frequently demanded by institutional investors. Yet, the concept of non-financial reporting is still relatively young and the experiences with the European non-financial reporting directive still limited as the second season of reporting non-financial information in accordance with the directive has just been passed. According to Deutsches Aktieninstitut’s point of view, it would be premature to enact new non-financial reporting requirements on the occasion on the forthcoming review of the European Non-financial Reporting Directive (NFRD) next year. A thorough impact assessment based on reporting experiences gained during several – in any case more than two – reporting seasons, should be conducted ahead of any deliberations for new reporting obligations. Moreover, the practicability of the newly adopted EU Commission’s non-binding guidelines on non-financial reporting encompassing the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) should be awaited prior to any new action taken in the field of non-financial reporting.



3 FOR A PRACTICABLE GREEN BOND-STANDARD

A European Green Bond Standard needs to establish practicable conditions as regards the emission of green bonds. In order to make a European standard a widespread success, horizontal finance purposes related to corporate sustainability should be considered in addition to emissions precisely corresponding to single green projects. In order to achieve a level playing field of rules, an EU Standard should be closely aligned with the Green Bond Principles of the International Capital Market Association.

4 FOR A STRONG AND SUSTAINABLE CORPORATE GOVERNANCE WITHOUT OVERLOADING THE CORPORATE PURPOSE

While the purpose of Corporate Governance codes is to ensure good checks and balances within the company, it cannot be regarded as a suitable tool for the transposition of ESG-objectives. Codes can contribute to a greater level of corporate sustainability by highlighting the importance of the right company-structures. Integrating advice for business models like the transformation to circular economy, etc. ranges however far beyond a code's purpose. Unrealistic expectations of the public vis-à-vis enterprises should not be given rise.

3. Strengthening the Internal Market by creating an EU legal framework for cross-border investment protection

Corporate cross-border investments within the EU are a crucial cornerstone for the functioning of the Internal Market. For example, more than 3 million employees work for EU companies in which German investors hold a participation.

Unfortunately, in a number of Member States the legal standards as defined by EU law are not always fully respected and implemented. Discrimination and unfair treatment of foreign companies from other EU Member States still occurs. Furthermore, some Member States lack effective and independent judicial protection.⁵ For many investors, the resulting lack of legal certainty is an obstacle for cross-border investments in Europe.

Until now, investor-state arbitration based on intra-EU investment agreements between Member States as well as the Energy Charter Treaty have provided legal certainty and effective investment protection in Europe.



⁵ European Commission (2018): The 2018 EU Justice Scoreboard. Online at: <https://bit.ly/2xlg4Gp>.

Unfortunately, following the “Achmea” judgment of the European Court of Justice, those agreements shall be terminated at the end of 2019. However, their termination without an effective replacement mechanism would leave investors without appropriate legal protection. Furthermore, the termination will also lead to a systematic discrimination of EU investors compared to third country investors, which continue to enjoy the protection under their EU-third country investment agreements.

„The establishment of a binding dispute settlement mechanism based on EU law is of utmost importance.“

To ensure a continuous protection of European investments and to strengthen the investment climate, the establishment of a binding dispute settlement mechanism based on EU law is of utmost importance. It would ensure a level playing field of European investors and those from third countries, such as the United States and, in the future, the United Kingdom.

The incoming EU Commission should address this subject with high urgency and design an EU legal framework, which guarantees the protection of foreign investment across member-state borders.

4. Proportionate Framework for an EU Consumer and Investor Protection needed

Preventing competitive disadvantages for the European Union vis-à-vis third country competitors also requires striking the right balance in consumer- and investor protection. Both, consumer- and investor-protection are important factors for creating trust in the economy, which is an essential factor for delivering growth and prosperity. Deutsches Aktieninstitut believes that the fundament for effective consumer- and investor-protection is widespread financial and economic literacy.

A sufficient level of financial literacy should be ensured. Investors must be enabled to make sound investment decisions in their own responsibility. Future efforts to reform the European framework for investor protection thus should focus on a widespread economic literacy as core element. The objective of promoting education in order to achieve an economy based on knowledge and innovation, as contained in the EU 2020 Strategy⁶, should include measures to improve financial and economic literacy. Investors should be put in a position to evaluate and compare financial instruments and to make informed and sensible investment decisions. The limiting factor in this field is not the availability of information, which is provided by the suppliers according to a bulk of regulations, but the understanding of the information and its consequences by the private investors.

⁶ European Commission (2010): Europe 2020 – A strategy for smart, sustainable and inclusive growth. Online at: <https://bit.ly/2zpxlN7>.

IN A NUTSHELL:

Even if the European Union is currently facing severe developments, there is reason for optimism. The EU can overcome the present difficulties by strengthening the economic positioning of Europe in the world. This requires EU policy-makers and the business community to understand each other's challenges, to acknowledge that they depend on one another and to realize that team play between them is essential. Embracing the European idea by standing together is the key for positive change!



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