

# Regulatory Developments in Europe: 2019 Outlook



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## Overview

Mid-2019 will mark the beginning of a new EU legislative term, with the election of a new Parliament in May and new Commission by November, paving the way for the introduction of fresh policy agendas. Ahead of this, we anticipate a renewed wave of activity aimed at realising outstanding items on the current legislature's list. This will include seeking to progress files under the banner of the Capital Markets Union, with sustainable investing now positioned as one of the core components of this initiative.

Environmental, Social and Governance (ESG) considerations are increasingly important factors in investment practice in Europe, and have risen up the policy agenda in 2018. This will continue in 2019. Transparency around investment stewardship and engagement practices with investee companies will also be bolstered by the entry into force of the revised Shareholder Rights Directive in June.

The year ahead will see continued efforts, both at EU and Member State level, to secure the long-term financial security of individuals through reforms to second and third pillar pension programmes. Investor protection was also a priority throughout 2018, through the implementation of MiFID II and the Packaged Retail and Insurance-based Investment Products (PRIIPs) Regulation, which have prompted operational changes by financial service providers targeting improved transparency, retrocession bans, and more robust suitability assessments. In parallel, the European Commission continues work on reducing barriers to competition in the provision of cross-border financial services in a number of areas. Ensuring fairness for consumers and an uncompromised quality of service will remain a focus for regulators in 2019.

Elsewhere, market structure is in a period of reform and will adapt as MiFID II continues to bed in, and market participants transition away from LIBOR. We expect to see refinement of the MiFID framework under the new EU legislature, and for financial stability more broadly to remain under discussion at both a regional and global level.

Preparations for a post-Brexit financial system in Europe have influenced the regulatory agendas in the UK, and to an extent the EU27, as the negotiations reached their crux in 2018. The prospect of the UK leaving the EU has spurred EU27 policymakers to renew their regulatory framework. Policymakers have sought to gain some control of their borders by reviewing the supervisory infrastructure in Europe through the ESA Review, and ensuring alignment of cross-border practices.

BlackRock continues to advocate for our clients and contribute to policy debate that brings about positive change for end-investors.

In this *ViewPoint*, we set out the significant developments in financial services policy, impacting retail investors, institutional investors, and distributors in Europe.

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## Developing market based finance in the European Union

### Capital Markets Union: The road to deeper, better connected capital markets in the EU

The Capital Markets Union (CMU) has been the flagship financial services initiative of the outgoing EU legislature. Conceived at the beginning of the current European Commission, it aims to build deeper and better-connected capital markets in the EU by attracting more long-term investment, encouraging more diverse forms of non-bank finance, and breaking down barriers to the cross-border capital flows.

The 2015 CMU Action Plan set out a range of legislative measures intended to further these goals: from securitisation reform ([page 4](#)), revisions to the Prospectus Regulation, and the creation of a Pan-European Personal Pension Product ([page 15](#)), to more politically challenging structural measures, such as the reform of national insolvency regimes or withholding tax systems. The Action Plan also led to further non-legislative work, such as an Action Plan on retail financial services, a report on cross-border barriers in clearing and settlement, a report on liquidity on corporate bond markets ([page 5](#)), and a review of the cumulative impact of EU financial services legislation, which itself prompted targeted changes to the existing EU legislative framework (for example, the EMIR REFIT – [page 22](#)).

Over time, the perimeter of the CMU initiative evolved further. Subsequent legislative proposals – such as the European Supervisory Authorities review ([page 5](#)) or the Investment Firms Review ([page 27](#)) and Action Plans – such as the Sustainable Finance Action Plan ([page 6](#)) were branded as integral parts of the CMU, giving additional political impetus to their consideration and adoption. The CMU was also used as the framework to address barriers to completion of an EU Banking Union – for example, measures aimed at addressing persistently high volumes of non-performing loans (NPLs) in EU banks.

The 2016 decision by the UK to leave the EU and the subsequent attention devoted to Brexit ([page 29](#)) undoubtedly gave the CMU a new urgency, with London, the EU's largest capital market centre likely outside the Single Market in future. It also took on a new political dimension: namely, how open EU capital markets should remain to the rest of the world (and the UK) following Brexit.

Going into the final year of this European Commission, the CMU remains an important priority. In November 2018, the Commission sought to increase the political pressure on the European Parliament and Council to accelerate negotiations on a range of outstanding legislation. The Parliament and Council had only agreed upon 3 of the 16 legislative

proposals under the CMU initiative. While more are very likely to be adopted in Q1 2019 (the final months of the current legislative term), it is also likely that a number of these proposals will fall to the next term, to be taken forward by a new European Parliament and Commission.

BlackRock has supported the CMU since its inception, and remains supportive of efforts to broaden, deepen, and integrate Europe’s capital markets, both with one another, and with the rest of the world. In the next legislative term, we believe that ample opportunities remain to further the CMU through revision of existing rules. However, we also encourage EU policymakers to build off the positive work done to date and, in particular, to look closely at how to better engage retail investors in capital markets.

### Cross-border distribution of investment funds

IMPACT	Asset managers; retail and institutional investors
JUN 2016	European Commission consultation on cross-border distribution of funds published.
JUN 2017	CMU Mid-term review published, with cross-border distribution of UCITS and AIFs as priority action.
MAR 2018	European Commission published proposals for targeted reviews to UCITS and AIFMD distribution and marketing frameworks.
JUN 2018	Council position agreed
DEC 2018	European Parliament position agreed
JAN 2019	Trilogue negotiations began

In December 2015, the European Commission began to assess how the European market for retail financial services – namely insurance, loans, payments, current and savings accounts, and other retail investments – could be further opened up.

The European Commission subsequently issued proposals in March 2018 to encourage the increased cross-border distribution of investment funds by reducing many of the existing administrative barriers. The proposals aim to bring better results for consumers and firms, while maintaining investor protection. The measures focus on:

- Removing the obligation to appoint a local paying or facilities agent, allowing firms to rely more on the Internet to meet consumer queries about product features.
- Further streamlining the process for cross-border notification and payment of regulatory fees.
- Providing a more consistent approach to de-registration of individual funds.
- Encouraging more consistent and transparent marketing standards in different Member States and including controls on ‘pre-marketing’ to allow managers to test investor interest in a proposed fund without triggering notification requirements

The proposals are not intended to fundamentally restructure distribution in individual EU member states. We believe they will bring many operational benefits, however, reducing the costs of operating on a cross-border basis, bringing benefits to end-investors. The European Council and Parliament are currently negotiating a final text, which we expect to bring more clarity on the scope of the pre-marketing regime and process for registering funds.

### Key features of the European Commission’s retail financial services strategy

The Europeans Commission is reviewing the markets for the provision of cross-border financial services in the EU, looking at ways to facilitate:

- Companies based in one Member State to offer financial services in another.
- Consumer access to retail financial services offered in other Member States.
- Citizens’ ability to take financial services with them when moving from one Member State to another.

### MIFID II: The cost of research

IMPACT	Asset managers, research providers, retail and institutional investors
APR 2016	Delegated Act on investment research published.
JAN 2018	MiFID II took effect.
2018 - 2019	Ongoing market studies by ESMA, FCA and other supervisors on the impact of the new research rules.

The second Markets in Financial Instruments Directive (MiFID II) makes significant changes to the asset management industry’s consumption of and payment for investment research. Previously, the cost of research was often bundled into the dealing costs taken from client accounts. ‘Research’ includes:

- Access to expertise and bespoke requests: providing access to subject matter experts and requesting bespoke work from these experts.
- Written research: on macro, thematic and company specific analysis.
- Models and data: providing models of companies and analysis of data on specific sectors or industries.

MiFID II requires the cost of research to be unbundled from the cost of trading, in order to improve transparency for clients around asset managers’ use and payment for external research. The requirement looks to break the link between the amount paid for external research and the volume or value of trading activity.

The options for research payments available under MiFID II are:

- Asset managers absorb the cost of external research by paying for it directly from their own resources.
- Continue to charge clients for the consumption of external research through a charge collected alongside trading but ring-fencing the money within a new 'Research Payment Account'.

Asset manager responses to the new requirements have varied: some firms continue to charge clients directly for research, some continue to charge but reassessed their fee structure, and others absorb the cost themselves.

From January 2018, BlackRock has paid for the cost of research consumed on behalf of MiFID-impacted funds and client accounts, decreasing costs of these portfolios for end-clients. MiFID II does not change our investment approach, and we will continue to leverage external research that adds value for our clients. BlackRock's primary objective is to source the best ideas and research both internally and externally. We are disciplined in our consumption of external research in line with set budgets, and have significant internal research capabilities.

Throughout 2018, EU regulators have been assessing the impact of the new rules on the availability of research on issuers, such as SMEs, and the ability of research providers to compete effectively for business. It remains to be seen whether this will result in further regulatory guidance or evolve into more wide-ranging legislative changes in future.

#### Key Features of MiFID II research requirements:

- Charges for investment research unbundled from costs for trading volumes.
- Asset managers to pay for research from either their own resources, or charge clients via a ring-fenced 'Research Payment Account'.
- Payments for research to be made from separate budgets, made clear to the clients ex-ante, if clients are being charged.

### Securitisation

IMPACT	Securitisation issuers, sponsors, and investors (e.g. pension funds, insurance companies, banks and investment funds)
	Original risk retention rules agreed in Capital Requirements Directive II (CRD II) (2009), and subsequently extended to other investors under Solvency II (2009) and AIFMD (2011).
SEPT 2015	European Commission published its proposal for an STS Securitisation Regulation.
DEC 2017	STS Securitisation Regulation published in the Official Journal of the EU.
JAN 2019	Most provisions began to apply – with transitional arrangements for existing deals, and where technical standards are to be finalised.

The European Securitisation Regulation, effective from 1 January 2019, intends to increase securitisation issuance in Europe, and to attract a wider and deeper investor base into the EU market.

The full set of supplementary (Level 2) rules has seen delays, and will not be in force as the new regime goes live in January – notably the final Simplicity, Transparency, and Standardisation (STS) classification standards themselves (only published on 12 December 2018 and coming into force 15 May 2019), as well as the issuer disclosure templates, where the final standards are still to be amended by ESMA.

We therefore anticipate that there will be few STS securitisations offered in early 2019, as the market digests the final rules. As new issuance begins, we expect the market – issuers and investors – will become more comfortable with the standards and the volume of STS securitisation deals will grow. While factors beyond regulation (such as central bank purchase schemes) have weighed on issuance levels in recent years, addressing the patchwork of legal frameworks for issuers and investors, and relaxing potentially excessive capital requirements for some deals, should be a meaningful improvement for European securitisation markets.

Ultimately, the success of the Regulation will depend on both issuer and investor take up of STS securitisation deals, and on attracting a wider investor base back into the market. Finalisation of the rules, which have been under discussion since the financial crisis, provides a more certain outlook on which market participants can base strategic asset allocation and funding decisions. The Regulation allows asset owners to outsource the due diligence to asset managers, who may have more experience in analysing securitisations, potentially improving their attractiveness to a wider group of investors. However, more specifically, the adjustments to Solvency II will make some parts of the securitisation market more appealing to larger insurers who had reduced exposure under the old rules.

#### Key features of the STS securitisation regulation:

- Establishes a new category of European securitisation: those meeting minimum criteria for Simplicity, Transparency, and Standardisation (STS) will receive preferential treatment in applicable prudential rules (e.g. Solvency II, the CRR framework) relative to other securitisations
- Assigns risk retention and transparency obligations directly to issuers of securitisations
- Extends the existing investor due diligence and risk retention verification requirements to all EU-regulated investors.

## EU corporate bond markets

Fixed income markets have undergone significant structural change since the 2008 financial crisis. Investors face new challenges as to how they trade fixed income, build bond portfolios, and manage risk. The bond market's evolution can be analysed through three related lenses: the liquidity environment, market structure and product preferences. All three are changing in the post-crisis era, with implications for the shape of the future bond market, investors and the regulatory framework.

In late 2017, the European Commission's Expert Group on Corporate Bonds issued a report proposing recommendations to improve the functioning of the EU corporate bond markets. Delivering in-depth analysis and the necessary policy recommendations to address friction and inefficiencies in today's EU corporate bond market has been a long standing objective of BlackRock's policy engagement on the Capital Markets Union (CMU) initiative.

The report concluded that the functioning of European corporate bond markets needs to be enhanced. Concerns have been raised about a perceived reduction of secondary market liquidity, the segmentation of corporate bond markets along national lines, and more generally on the functioning of corporate bond markets. Specifically, the Expert Group found that the issuance of corporate bonds has significantly increased over the last few years, driven by low interest rates and the Corporate Sector Purchase Programme (CSPP) of the European Central Bank. Questions remain about whether this trend is sustainable if and when the favourable economic

environment changes. In any case, the Expert Group found that there is underused potential: the value of European corporate bond market represents less than one third of that of the US (10% of GDP in 2017, compared with 31% in the US).

The Expert Group's recommendations serve as a basis for national and European authorities to agree follow-up actions pursuing the following six objectives:

1. Making issuance easier for companies;
2. Increasing access and options for investors;
3. Ensuring the efficiency of intermediation and trading activities;
4. Fostering the development of new forms of trading and improving the post-trade environment;
5. Ensuring an appropriate level of information and transparency; and
6. Improving the supervisory and policy framework.

The Expert Group also noted that Exchange Traded Funds (ETFs) can be an effective way for retail investors to access different asset classes (including corporate bonds), advising the Commission to review Member States' regulations and market practices to identify the obstacles that stand in the way of investors trading ETFs on exchange.

The European Commission could propose policies to tackle inefficiencies in European corporate bond markets under the new legislature in 2019 at the earliest. BlackRock will continue to feed into this work, bringing the perspective of the end-investor to the discussion.

## Review of the European Supervisory Authorities

IMPACT	All financial institutions supervised in the EU
MAR 2017	European Commission published a consultation on the operations of the ESAs.
SEP 2017	European Commission published proposals on the review of the European System of Financial Supervision, including amendments to the ESAs founding Regulations.
JAN 2019	Parliament agreed its negotiating position
FEB 2019	Council position and commencement of Trilogue negotiations expected

In 2017, the European Commission launched legislative proposals (the 'ESA Review') to review and amend the rules governing the operation of the three European Supervisory Authorities (ESAs): the European Securities and Markets

Authority (ESMA), the European Insurance and Occupational Pensions Authority (EIOPA), the European Banking Authority (EBA), and the European Systemic Risk Board (ESRB). The ESA Review's stated objective is to support the growth of European capital markets in the light of the UK's withdrawal from the EU, and to integrate stakeholder feedback. The asset management industry supports efforts to deliver greater supervisory convergence, but in a number of areas brings a different perspective to proposals for additional ESMA powers (see key features on the next page).

ESMA has a pivotal role to play in developing a better functioning European single market that puts the end-investor at its centre. Building trust in local capital markets is a precondition for developing effective EU capital markets; trust is the precondition for end-investors to invest. Rather than fundamentally restructuring the existing framework of

supervision, we believe that better supervisory convergence can be achieved by greater up-front coordination of authorisation and supervisory practices by National Competent Authorities (NCAs) with ESMA, and an increased use of joint peer reviews in cooperation with NCAs.

One of the most controversial questions has been the proposal to give ESMA the right to intervene in decisions by NCAs to approve the delegation of portfolio management and other core services outside the EU. Delegation is not about market access (as is the case with the European Commission's equivalence decisions). Delegation currently takes place in the context of a stringent European and national regulatory framework – rather than the framework of the 'third country' – and is subject to direct supervision by NCAs. European investors benefit from the EU's strong investor protection and risk management provisions (such as those in the AIFMD and UCITS Directive), and – through delegation – local portfolio management expertise from around the globe.

We believe there is merit in ESMA verifying whether the criteria or principles on which any third-country equivalence decisions have been based are still applicable. This would underpin the stability and continued supervision of third country equivalence. While there is benefit in enhancing ongoing third country equivalence assessments, the EU framework for delegation continues to be fit for purpose.

Looking at ESMA's strategic priorities, we recommend focus on the added value ESMA can bring by developing consistent standards, driving supervisory convergence, and ensuring that authorisation, supervision, and enforcement are consistently addressed by NCAs across the EU. ESMA's existing mandate for supervisory convergence can be used to ensure NCAs take account of matters of pan-European importance in a consistent way as and when they occur.

ESMA's other potential value add for supervisory convergence lies in increased coordination and standardisation of tasks around data reporting, for example the development over time of a European version of the US Securities and Exchange Commissions' Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system. ESMA could then more effectively analyse developments in the Single Market. The development of pan-European data analytics should not, however, undermine the ability of NCAs to obtain the data they need. ESMA could also take the lead in developing other areas of supervisory infrastructure: for example, ESMA could become the operator of a single European consolidated tape for equities, ETFs, and fixed income (see [page 19](#)), and a central hub for cross border fund notifications and marketing information.

### Key features of the Commission's proposals on the role of ESMA:

- Change to existing governance procedures with the creation of an executive board composed of the ESMA Chair and five independent members, with enhanced powers compared to the existing Management Board.
- Change to ESMA's funding model of EU and national funding, by partially replacing NCAs' contributions to the running of ESMA with direct contributions from firms.
- Stronger rule for the ESMA stakeholder group to challenge ESMA.
- Direct powers of authorisation over a range of European funds such as ELTIFs, EUVECAs, and EUSEFs.
- Direct oversight by ESMA of NCA's decisions to permit delegation of services, or other forms of risk transference, to third countries, and oversight of the European Commission's third country equivalence assessments.
- Greater focus on promoting sustainable investment in ESMA's work.

## EU Sustainable Finance

IMPACT	
JAN 2018	Final report of the High Level Expert Group (HLEG) published.
MARCH 2018	European Commission published Action Plan on sustainable finance.
MAY 2018	EC publishes first three legislative proposals (taxonomy, low-carbon benchmarks and disclosures) and consults on suitability.
JUNE 2018	Technical Expert Group (TEG) on Sustainable Finance formed.
JAN 2019	TEG to report on metrics for climate-related disclosures.
APRIL 2019	End of legislative term, final agreement on disclosures, low-carbon benchmarks possible.
APRIL 2019	EIOPA and ESMA to publish technical advice on sustainability integration.
JUNE 2019	TEG to publish final report on Green Bonds, taxonomy, and methodology for low-carbon benchmarks.

### The European Commission's Action Plan

In 2016, the European Commission convened a High-Level Expert Group (HLEG) on Sustainable Finance, to articulate policies to integrate concepts of sustainability into EU financial services legislation. Following the work of the

HLEG, the European Commission published its Sustainable Finance Action Plan, which put forward a range of legislative proposals, taking on a number of the HLEG's ideas.

In May 2018, the Commission introduced the first suite of legislative proposals, and consulted on important changes to the secondary rules governing how investment products and services are provided to investors:

1. A legislative proposal establishing a framework for a common **taxonomy**
2. A legislative proposal on sustainability **disclosure** obligations for investors
3. A proposed amendment to MiFID II's body of secondary rulemaking incorporating sustainability into the concept of investment **suitability**
4. A legislative proposal on low-carbon **benchmarks**

The package of measures is the intended basis for future work in this area – such as the establishment of a common taxonomy to allow the creation of more consistent labels and standards across the EU for sustainable investments and products.

BlackRock has welcomed the Action Plan: this agenda is important for Europe's end-investors and their financial futures – especially given the growth of sustainable investment in recent years in Europe and across the world. Underpinning sustainable finance with a robust framework (enabling end-investors to access best-in-class products with a financial and sustainability-related value component) is in the best interest of investors and the European market for savings and investment.

To make the agenda a success, it is important to ensure the Action Plan and its component pieces have clearly-articulated objectives. An approach to legislation that recognises the diversity of investment styles and of investor needs (and preferences) is important to ensure that sustainable investment presents an attractive investment option to as many end-investors as possible.

## A taxonomy of sustainable activities

Developing a common taxonomy for sustainable investment is the cornerstone of the European Commission's Action Plan. Definitions for sustainability used in the market vary widely; the taxonomy aims to bring about a shared understanding of what constitutes 'sustainability', providing the future basis for standards, labels, and reporting by companies and financial services providers.

The Regulation establishing a taxonomy sets out a legal framework to build a classification determining the environmental sustainability of a particular investment by defining 'environmentally sustainable economic activities'. The proposal would give the Commission the power, through

## BlackRock's mission statement on sustainability

We are an asset manager whose objective is to create better financial futures for our clients and the people they serve. We aspire to be an industry leader in how we incorporate sustainability into:

- Our investment processes and learning across the firm
- Our stewardship of our clients' assets
- Our sustainable investment solutions offered to our clients
- The operations of our own business.

As a fiduciary to our clients, BlackRock firmly believes that Environmental, Social and Governance (ESG) issues (ranging from climate change to diversity and board effectiveness) impact long-term financial performance and therefore are important considerations for investment and risk management.

As articulated in our [Mission Statement on Sustainability](#), our contribution to this agenda spans four dimensions:

1. Integrating sustainability insights into investment processes
2. Engaging with companies on their sustainability issues
3. Delivering sustainable investment solutions for our clients
4. Operating the firm for the long-term

secondary rulemaking, to identify activities which qualify as 'sustainable', taking into account existing market practices and initiatives, and drawing on the advice of a technical expert group that is currently being set up to advise the process.

To that end, in June 2018, the European Commission convened a 'Technical Expert Group' (TEG) on sustainable finance, comprised of financial institutions, policymakers, academics, think-tanks, and consumer groups. The TEG issued a report on metrics for climate-related issuer disclosures for consultation in January 2019, and will be followed by a final report on a taxonomy for Green Bonds, and low-carbon benchmarks in June 2019.

We support the Commission's efforts to establish a common language on sustainability. Well-crafted standard classifications can help harmonise approaches to designing 'sustainable investment products'. Instead of managing to a patchwork of different existing standards and labels in EU

Member States, a harmonised approach could lead to single standards used across the EU, allowing for more scalable (and therefore lower cost) investment solutions for end-investors.

However, the taxonomy proposal is focused on defining the degree of sustainability of specific 'economic activities'. While relevant for specific forms of project finance like Green Bonds, this is difficult to apply to (for example) an equity portfolio. Many types of direct project finance are difficult to scale in ways that are accessible to a wide range of investors – especially retail investors – and so the success of the taxonomy in delivering greater clarity to the sustainable investing landscape will hinge on how applicable it can be to a wide range of investment approaches. Investment funds often consists of hundreds or more financial instruments which lead to a multiple 'activities'. It would be burdensome and costly to determine the degree of environmental sustainability by assessing and tracking all activities of the respective companies.

For the taxonomy to be the base of sustainable finance in Europe, as it is intended to be, it must be updated regularly; be inclusive (not directive); and, enable market innovation.

## Investor Disclosures Regulation

The proposed Regulation creates obligations which apply to financial market participants (MiFID investment firms, UCITS managers, AIF managers, insurance firms who market insurance based investment products, and pension funds) and asks them to disclose how they integrate sustainability considerations in both dedicated sustainable finance products, and in their wider investment decision-making processes for non-sustainable products.

Examples of the types of transparency that would be asked of firms include:

- Disclosure of written policies regarding integration of sustainability risks in investment decision-making and description of different sustainability risks in pre-contractual disclosures.
- How the entity's remuneration policies are consistent with the integration of sustainability risks and are in line, where relevant, with the potential impact of sustainability-related risks on a particular financial product.
- Specific disclosure requirements for products or services marketed as 'sustainable', which will have to detail how they define, measure, and achieve their sustainability targets.

Both the European Parliament and Council finalised their respective positions on the proposed Regulation in 2019. It is therefore expected that a final legal text could be agreed in Q1 2019. While the Council text largely makes technical amendments to the Commission proposal, the Parliament has introduced a number of concepts which are more controversial and may make negotiations more challenging in 2019.

In particular, the Parliament has introduced a mandatory due diligence requirement on all investors and investment service providers to identify, avoid and mitigate sustainability risks before investing, as well as widened the scope of the disclosures required of sustainable investment products in Regulation to all investment products.

We support the intention to encourage greater ESG integration through transparency on investment and risk management policies; this provides the right incentives and avoids imposing a uniform means of integrating sustainability. Equally we believe that disclosure and transparency is the most appropriate way to help address the risk of 'greenwashing' when it comes to sustainable investment processes.

Above all, we believe that policy measures in this space should be additive to investor experience – that is, investors' ability to make better informed choices and access efficient investment products. To the extent that disclosure or other requirements fail to deliver tangible investor benefit, it is likely that their greatest impact will be to add undue cost to investment products, thereby making them less attractive to investors, and raising the cost of funding they provide to the companies and projects they invest in.

## MiFID II suitability requirements

The Sustainable Finance Action Plan also proposes amendments to the investment suitability requirements under MiFID II. Currently, investment advisers and providers are required to determine client's investment objectives, risk tolerance, and ability to bear losses at point of sale, and to conduct ongoing suitability checks. The proposals would require suitability tests to incorporate a potential investor's sustainability preferences, and reflect these in product recommendations.

We support the goal of increasing offerings of sustainable products to investors and better integrating sustainability considerations in financial advice across Europe. However, this is unlikely to be a straightforward exercise – especially for retail investors.



The design and implementation of the existing MiFID II suitability test was a long and exceedingly thorough process. Significant work has since been done by advisors, distributors, and product providers to put the correct infrastructure in place for the requirements. These processes are only beginning to bed down; adding additional requirements around an area as complex as sustainability at this late stage could create uncertainty over how to balance existing with new requirements, especially given that a number of unresolved issues remain.

For example, it is unclear how client sustainability preferences should be weighed against existing suitability criteria such as risk tolerance, investment objective, or cost efficiency. We recommend that an investor's ESG preferences are taken into account once an investor's primary objectives have been established. Another issue is the lack of clear definition of a 'sustainable investment product' in the various proposals under the Action Plan. The use of the definitions used elsewhere for suitability assessments may have the unintended effect of strongly limiting possible sustainable investment products to those with an impact-focus. These products may not be financially appropriate for many investors, and in any case would restrict the possible use of other approaches to sustainable investing, such as ESG best-in-class or exclusionary screening, to meet investors' sustainability preferences.

We believe working towards a framework that balances investors financial needs with their sustainability preferences is a medium-term goal – but one that can pay strong dividends in the long run by helping to engage more investors.

## Carbon-related benchmarks

Finally, an amendment to the EU Benchmarks Regulation looks to bring 'low-carbon' and 'positive-carbon' benchmarks into scope of the Regulation. In a low-carbon benchmark, underlying assets would be selected with the aim of reducing carbon emissions of the index portfolio relative to a parent index, whereas a positive carbon impact benchmark would seek to align with the Paris Agreement objective of limiting global warming to below 2° C.

The intent is to give market participants the same level of confidence in the reliability of these carbon-related benchmarks as that expected of all benchmarks and indices authorised under the Benchmarks Regulation.

We welcome the attention on carbon benchmarks and support the move to treat them in the same way as other benchmarks from a regulatory perspective. However, we believe the questions central to their wider adoption will have as much – if not more – to do with building consensus in the market around the underlying concepts (such as the definition and measurement of so-called Scope 3 carbon emissions), as will the legal framework they fall under.

## Investment stewardship and corporate governance in Europe

BlackRock believes in promoting sound corporate governance practices, acknowledging regional variations in corporate law, market practice, and culture. As a fiduciary investor, it is important to be actively engaged in policy and market issues that affect the long-term value of our clients' assets. BlackRock's Public Policy team engages with policymakers to offer an investor perspective on issues that affect our clients' investments and the functioning of global capital markets. In partnership with Public Policy, BlackRock Investment Stewardship is engaged on the governance, reporting, and shareholder rights aspects of regulation and governance standards.

Corporate governance and investment stewardship continue to be of interest across Europe. Legislation and industry standards have continued to be revised, in light of increased scrutiny from both policymakers and end-investors.

### National stewardship and corporate governance reforms



UK

2018 saw numerous legislative proposals, consultations, and parliamentary inquiries in the corporate governance space. We will likely see marked changes to the UK corporate governance landscape, affecting both listed companies and their investors, in particular on pay, accountability of boards and stakeholder inclusion.

These initiatives follow on from the Government's 2017 Green Paper [proposals](#) on corporate governance reform, centring on executive pay and stakeholder engagement; and recent corporate failures in the UK, such as Carillion in early 2018.

The UK also witnessed its first reporting exercise by large public and private companies on their gender pay gap. Subsequently the government conducted an [Inquiry](#) into 'delivering on fair pay', and is also looking into [ethnicity pay reporting](#). Pay will continue to be in focus in 2019.

Two noteworthy events coming from the Green Paper are proposed reporting requirements on pay and stakeholder engagement; and consultation by the UK Financial Reporting Council (FRC) on the UK Corporate Governance Code.

## Reporting requirements on pay and stakeholder engagement

The Government will introduce secondary legislation requiring 'premium' listed companies to report the ratio of CEO pay to the median pay of their UK workforce, with an explanation of changes to the ratio from year to year and its relation to pay and conditions across the wider workforce.

It will also introduce secondary legislation requiring companies with over 250 UK employees to describe how their directors have taken into account the requirements under section 172 of the Companies Act 2006, including consideration of the long-term impacts of decision-making, the interests of the company's employees, relationships with suppliers and customers, impact on the environment, and the company's reputation.

The new requirements will apply to company reporting on financial years starting on or after 1 January 2019. The first actual reporting under the new regulations will therefore start in 2020.

## FRC consultation on the UK Corporate Governance Code

The UK Financial Reporting Council (FRC) published its revised Corporate Governance Code in July, following a consultation earlier this year, to which we submitted a [response](#). We welcomed the majority of changes in the revised Corporate Governance Code. We believe the simplified Code should refocus boards, investors and other stakeholders on the importance of the flexibility offered by the 'comply or explain' approach – a flexibility which we believe has been eroded over the years.

The Code also now focuses on a broad set of company stakeholders, including the company's own workforce. We are disappointed that the Code contradicts its own intended flexible approach by indicating three prescriptive models for boards to use to engage with the company's workforce. We would have preferred the code to take a less directive approach which would encourage boards to explain why their own chosen method is considered most effective for their company. The new Code will apply to accounting periods beginning on or after 1st January 2019.

We expect the FRC to launch a consultation on revisions to the UK Stewardship Code by January 2019.

## Independent review of the FRC

The UK Government launched an independent review of the FRC in order to assess the FRC's governance, impact and powers, and to help ensure it is fit for the future. This review is largely a result of the Carillion joint inquiry earlier this year, where the quality of the FRC's oversight of audit and corporate reporting was scrutinised by the Select Committees of the Departments for Business, Energy, and Industrial Strategy (BEIS) and for Work and Pensions (DWP).

As part of this review, a call for evidence was published in June. BlackRock submitted a [letter](#) in response stating our

overall support of improving the FRC's oversight by clarifying its roles and responsibilities, extending its sanctioning powers, and augmenting its resources.

We believe that maintaining the status quo is not an option for the FRC; equally, we do not consider a full overhaul of the FRC to be necessary to fulfil its objective of ensuring "a strong flow of investment into UK companies so they can grow and support society".



## Netherlands

### New Dutch Stewardship Code

The first Dutch Stewardship Code was developed in 2018 entered into force on 1 January 2019. It is a timely advance of the Eumedion Best Practices for Engaged Share-Ownership of 2011. Furthermore, the Code will be an important component of ongoing obligations on pension funds, insurance companies and asset managers, that arise from the revised Shareholder Rights Directive (see [page 11](#)). Notable principles of the new Code include:

- Asset owners and asset managers should have a stewardship policy that aims to promote long-term value creation at Dutch-listed investee companies
- Disclosure of full equity holding when entering into dialogue with an investee company
- Disclosure of full voting records (at an individual company level and per voting item)
- Stricter policies with respect to stock lending

We are generally supportive of the Dutch Stewardship Code. We provided feedback on the draft consultation released by Eumedion in the autumn of 2017, and will be updating our statement on compliance with the new Code in H1 2019.



## France

### French Government's Action Plan for the Growth and Transformation of Enterprises

The French Treasury has undertaken a major reform of French companies of all sizes to reduce red tape, reinforce entrepreneurship and make French companies more attractive in international trade. This flagship reform is called PACTE (*Le Plan d'Action pour la Croissance et la Transformation des Entreprises*).

Two measures concern corporate governance of French listed companies:

- A revised legal definition of 'corporation'. Integrating the concept of 'corporate purpose' (*raison d'être*) which specifically includes social and environmental considerations by companies in their business strategy and activities.
- The French State to privatise three major companies (Groupe ADP / Aéroports de Paris, la Française des Jeux, and ENGIE).

Although we agree that companies should define their purpose and take into account the impact they have on their stakeholders and the environment, we view this reform as a missed opportunity for the French Government to make the corporate governance framework more aligned with its ambition of greater international investment attractiveness by ensuring a better protection of minority shareholders or by introducing a periodic shareholder vote on the “one vote, one share” principle in companies granting double voting rights. The PACTE Act could be approved by the French Senate in early 2019.

### Afep-Medef consultation on French Corporate Governance Code

Afep (Association française des entreprises privées) and Medef (Mouvement des entreprises de France), two French issuers’ organisations, recently published a consultation, inviting comments on proposed reforms to their Code of Corporate Governance. While we supported the changes introduced in the Code, such as the promotion of long-term value creation or the call for greater diversity in executive committees, BlackRock’s [response](#) focused on the drafting and monitoring of implementation of the Code. We believe a wider group of stakeholders, including investors and their representatives, should be involved. Without greater involvement from stakeholders, views and interests that could help further improve the governance of French companies will be missed.



Last year, the Belgian ministry of justice announced its intent to reform the Belgian Company Code (Dutch: Wetboek van vennootschappen / French: Code des sociétés). One of the measures being discussed is the introduction of ‘loyalty shares’, with double voting rights for shareholders who have held their shares for at least two consecutive years for private companies (Dutch: besloten vennootschappen / French: sociétés privées).

These companies are given the opportunity to include double or multiple voting rights in their articles of association, depending on whether or not they are listed.

BlackRock opposes the introduction of ‘loyalty shares’ in Belgian companies. Effective voting rights are central to the rights of ownership and we believe strongly in ‘one share, one vote’ as a guiding principle that supports good corporate governance.

Shareholders, as the residual claimants, have the strongest interest in protecting firm value, and voting power should match economic exposure. It is at the core of corporate governance that, to reduce the agency problem, all

shareholders need to effectively monitor companies. We therefore believe strongly in one vote for one share as a guiding principle that supports good corporate governance and best protects our clients’ investments in these companies on the long term.

### Shareholder Rights Directive

IMPACT	Pension funds, insurance companies, listed companies, and asset managers
JUN 2019	EU Member States – and the UK – to transpose the Directive into national law.
SEP 2020	Implementing Regulation regarding shareholder identification, the transmission of information, and the facilitation of the exercise of shareholders rights to apply.

The amended Shareholder Rights Directive (SRD II) applies to EU listed companies; institutional investors, asset managers, and proxy advisors invested in or advising on shares in these companies; and intermediaries that provide services to shareholders or other intermediaries of these companies’ shares.

From an investor perspective, insurers, pension funds, and asset managers will be required to provide greater transparency on their shareholder engagement policy, how they engage with companies they or their clients invest in, and their equity investment strategies. SRD II aims to incentivise a long-term approach and facilitate better investor-company relations across Europe. From June 2019 onwards, institutional investors and asset managers will be required to disclose a detailed shareholder engagement policy (on a ‘comply or explain’ basis), including disclosing voting records and voting rationale for their most significant votes. This disclosure should provide relevant and meaningful information that enables a better understanding of how institutional investors and asset managers fulfil their shareholder duties.

SRD II also requires institutional investors to publicise how their equity investment strategy is consistent with their long-term profile and liabilities; including how they encourage their asset managers to be long-term (e.g. the method and time horizon used to assess their performance). We believe the challenge for institutional investors will be to provide a clear picture of their overall equity investment strategy to the public, particularly where several entities manage the asset owner’s equity portfolio.

From the perspective of listed companies, SRD II introduces measures to align executive pay with the companies’ long-term interests and business strategies through the requirement for a remuneration policy. BlackRock supports

measures to closely link pay to companies' long-term strategy and goals, and also the right for shareholders to make their voice heard on companies' remuneration policies.

SRD II equally gives EU companies the right to have their shareholders who hold more than 0.5% of shares or voting rights identified. Intermediaries, (mostly custodians and Central Securities Depositories), are required to communicate details of shareholders identify without delay.

#### Key features of the Shareholder Rights Directive:

- Disclosure by institutional investors and asset managers of the shareholder engagement policy, including voting records and voting rationale.
- Publication by institutional investors of how equity investment strategies are consistent with long-term profile and liabilities.
- Measures for companies to align executive pay with long-term business strategy.
- Right for companies to identify of shareholders with more than 0.5% of shares or voting rights.

## Distribution and value for money

### PRIIPs – Packaged Retail Investment and Insurance Products

IMPACT	Asset Managers, Insurers, Issuers, Consumers
31 DEC 2017	The PRIIPS Regulation took effect.
2019	Review of the application of the PRIIPs to be completed by the European Commission.
DEC 2019	Original expiry for UCITS exemption from PRIIPs application.
DEC 2021	New expected expiry date for UCITS exemption (pending formal amendments to existing texts).

The Packaged Retail Investment and Insurance Products (PRIIPs) Regulation aims to provide a pre-contractual standardised disclosure document for all retail financial products, to improve product comparability and transparency. The Regulation covers a wide range of products ranging from corporate bonds, structured notes, retail investment funds (other than UCITS) and insurance products with an investment component. Pension products are excluded given the different nature of the underlying investment process.

Since the launch of the PRIIPs Key Information Document (KID) in 2018, industry and consumer organisations have called for an urgent review of the PRIIPs Regulation, citing

methodological issues with the presentation of performance and cost figures and uncertainty over the scope of the Regulation.

PRIIPs also provides a transitional period where prospective retail investors in UCITS will continue to receive a UCITS KIID until the end of 2019. The PRIIPs Regulation envisaged that the application of the PRIIPs KID standards to UCITS funds would be subject to a review, potentially leading to replacement of the UCITS KIID with the PRIIPS KID, or to retaining both documents.

Comparable and meaningful information for all savings products will foster consumer appetite for investing across Europe, contributing to the creation of a deep Capital Markets Union. However, information must be fair, clear and not misleading. A full review of the PRIIPs regime must therefore be undertaken before extending it further.

EU supervisors have underlined the need to maintain the original sequencing of the review to ensure that PRIIPs KID disclosure standards are suitable for UCITS disclosures, and that consumers will benefit from replacing the UCITS KIID with the PRIIPs KID. More recently, the European Supervisory Authorities (ESAs) expressed concerns about consumers receiving duplicative information from both a UCITS KID and a PRIIPs KID when investing in UCITS fund as of 1 January 2020. We agree that this would be undesirable, and consumers would require further explanations.

To expedite a single document, the ESAs announced they would make targeted revisions to the PRIIPs KID, in order to meet 2020 deadline. However, they currently will only consider performance scenarios and changes which can be addressed through further guidance. They have not mentioned the very contentious issue of transaction cost disclosures, which need further work (see [page 13](#)).

Various legislative initiatives are currently underway, including a European Parliament proposal to extend the UCITS exemption for two years, allowing for a full review of PRIIPs and possible corrections to methodological issues.

#### Key features of PRIIPs:

- A standardised Key Information Document for all retail financial products (except pension products).
- UCITS are temporarily exempt from PRIIPs requirements until December 2019, though this may be extended by a further two years.
- The PRIIPs KID provides standardised information, including a synthetic risk indicator, future performance scenarios, and aggregate charges and costs incurred over a given holding period.

## Understanding transaction cost reporting

Across the EU, a number of differing standards exist for disclosing the costs of investment portfolios, including those recently applied under PRIIPs and MiFID II, and a range of national disclosure requirements for pension fund costs. These standards look to enhance the visibility of transaction costs alongside other charges, to empower more effective investor decision making.

Charges are fees paid to a fund or investment manager or third party distributor as compensation for providing a service such as portfolio management or investment advice. Transaction costs incurred in delivering an investment strategy; portfolio managers cannot deliver a strategy without incurring these costs. Transaction costs do not accrue to the manager, but consist of either explicit costs (such as brokerage costs or transaction taxes such as stamp duty) or implicit costs (reflecting the market impact of a manager's trading strategy). Transaction costs should not be viewed in isolation; they should be considered in the context of net performance delivered by managers running similar strategies. Disclosures should provide investors with a tool for assessing how effective a portfolio's trading activity is in achieving its stated objective.

The table on the right shows some of the disclosure standards in place across Europe. There is currently no consensus on how to measure portfolio transaction costs, making direct comparison of products difficult. Ultimately, this means investors are unclear of what they are paying for. Given the broader adoption of the PRIIPs standards by UCITS funds (see [page 12](#)), it is crucial that there is a consistent application of the PRIIPs standards in a way which is accessible to investors.

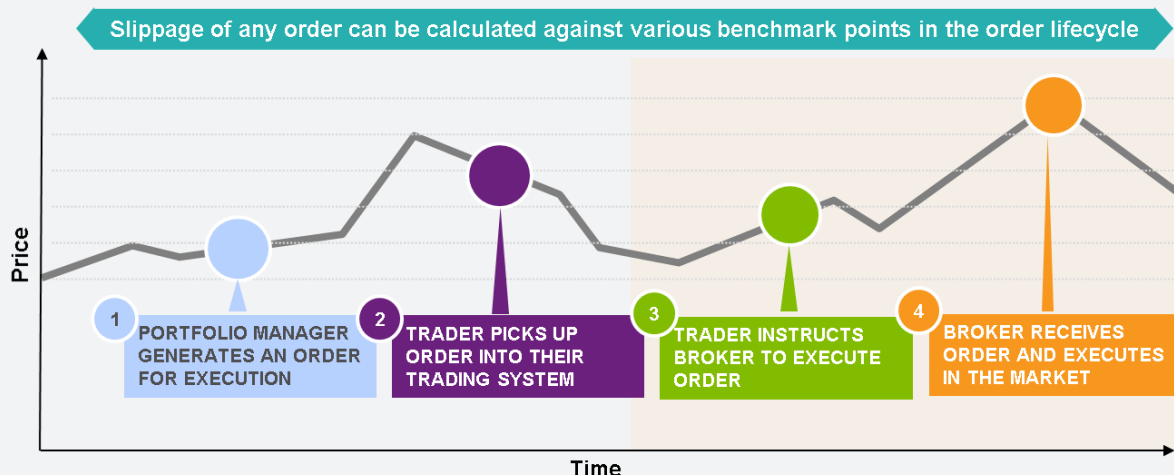
There are two main approaches to calculating transaction costs; the Slippage approach, which seeks to

measure the actual cost per trade, and the Spread approach, which assigns representative costs to the trading activity instead.

	Standard	Methodology
EU	PRIIPs	Slippage methodology used where a product has been operating for three or more years. Estimated costs used for underlying assets other than liquid instruments.
	UCITS	'Ongoing Charge Figure' (OCF) does not include performance fees or transaction costs: Performance fees are stated separately, net of transaction costs.
	MiFID II	ESMA expects the PRIIPs methodology will be used, but others, such as Spread, have been deemed to meet MiFID's objectives.
NATIONAL	Federation of Dutch Pension Funds (Netherlands)	Spread methodology: investment firms can set their own or apply industry averages.
	FCA PS17/20 (UK)	Slippage methodology.

Slippage compares a benchmark price to the price at the execution of the trade – seeking to directly measure the actual cost per trade. A benchmark price is selected by the fund manager at any point before the trade that they feel is most representative (see Exhibit A). The calculation will therefore vary depending on the fund manager's access to data, the type of security traded, the sample size of the trade, and many other considerations. As Exhibit A shows, Slippage figures are often volatile and sensitive to market movement, leading to repeated instances of negative transaction costs.

### Exhibit A: Potential benchmarks used to calculate Slippage

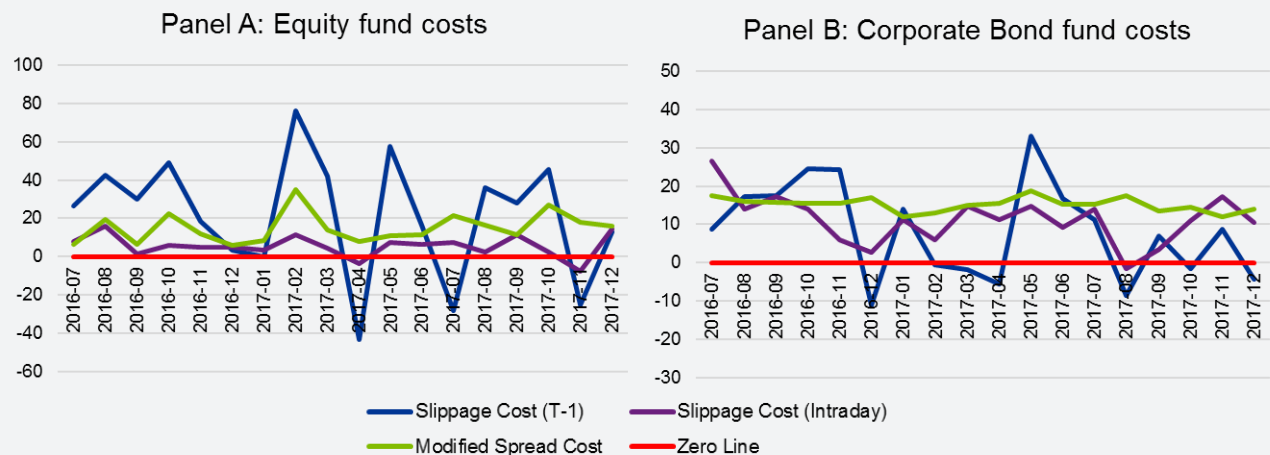


## Understanding transaction cost reporting

The Spread methodology estimates the typical cost of a particular transaction, removing many of the statistical hurdles related to Slippage, while introducing other challenges. The typical cost of trading a particular type of security will be based on the fund manager’s experience of trading that security, but can also be calculated for newly launched funds based on their target holdings and expected transactions. This process is less tied to market movements, removing the possibility of negative transaction costs (see Exhibit B). However, as Spread costs are set by the fund manager, there is an incentive to produce inaccurately low estimates. Data must therefore be sufficiently precise and accurate; that is, data must be current, comprehensive, and reflect the average transaction size in a portfolio. Such data may not be available.

In our [ViewPoint: Disclosing transaction costs – The need for a common framework](#), we set out our analysis and recommendations, concluding that a ‘Modified Spread’ methodology could overcome some of the challenges with current methodologies and present a more comparable and informative transaction cost figure. Instead of adhering to a single formula to represent the cost of trading across multiple strategies and asset classes, fund managers could calculate the cost of trading instruments in a specific asset class taking into account all the relevant factors. This would permit estimates based on the attributes of the asset class most relevant to transaction costs. Disclosing the relevant factors considered in the estimates would reduce moral hazard risks, and provide greater transparency for investors.

**Exhibit B: Monthly fund cost disclosures based on modified spread cost**



Source: BlackRock proprietary data

## MiFID II and the Insurance Distribution Directive

IMPACT	Retail investors and institutional investors, distributors, wealth managers and asset managers.
JUL 2017	ESMA final report on Product Governance published.
DEC 2017	IDD technical standards on Product Governance and Investment Products approved – publication expected in Q1 2018.
JAN 2018	MiFID II took effect.
OCT 2018	IDD rules took effect.

MiFID II aims to enhance investor protection in distribution channels for the sale of financial products through upgrades

to client servicing models, increased transparency, and product governance.

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. We believe 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. The recently finalised target market rules from MiFID, and guidance from ESMA, will lead to greater exchange of data between manufacturers and distributors.

Product manufacturers will need to provide more data on how their products are designed to perform and build more holistic product development and governance processes

drawing on a greater understanding of end investors' needs. Distributors will need to provide data on whether products have been sold as intended. This has resulted in the welcome development of a number of industry templates to facilitate the flow of information.

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

The new requirements have brought into focus the importance of clarity of target market and so-called 'clean' commission free share classes where varying local distribution requirements are emerging.

There is, nevertheless, a risk that the cumulative effect of the additional obligations under MiFID II price out many retail investors from accessible advice, creating an advice gap (as seen in the UK Retail Distribution Review). Regulators and industry are actively considering how the majority of the market will access financial advice in the future, especially through the use of technology such as automated advice.

The Insurance Distribution Directive (IDD) is similar in scope to MiFID II, but applies to the distribution of insurance products and its go-live date is due to be delayed until October 2018. While the IDD has similar requirements on assessing the target market of products and cost disclosure as MiFID II, it stops short of prohibiting the retention of commissions. Rather it includes requirements that payment of commissions should not be to the detriment of the policyholder.

#### Key features of the MiFID II distribution requirements:

##### 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 advisers and discretionary portfolio managers.
- Quality enhancement required for non-independent advisers and execution only platforms to retain commission.

##### Cost disclosures

- Transparency to the client on the total cost of investing, including total costs charged by the MiFID firm for services such as advice or 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.

## Retirement

### Pan-European Personal Pension

IMPACT	Individuals looking for a personal pension, insurance companies, asset managers, and other pension providers
JUL 2016	European Insurance and Occupational Pensions Authority published advice for the Commission on potential for an EU internal market for personal pensions.
JUN 2017	European Commission published a proposal for a Pan-European Personal Pension product.
Q4 2018	Provisional political agreement reached between the European Commission, Parliament, and Council on the final text, due to be formally signed off in H1 2019.
2019	Expected consultations on implementing measures such as the detailed framework for lifecycling, standards of investor disclosure and costs.
2020 / 2021	Earliest go-live date for the PEPP at European level. Actual start date depends on Member States clarifying the national tax treatment of PEPP compartments.

The European Commission has developed the framework for a Pan-European Personal Pension (PEPP) product that could play a role in both encouraging EU citizens to save adequately for retirement, and channel those savings into the economy, via companies and projects that deliver a return for the saver.

The PEPP aims to offer a standardised personal pension vehicle, with a specific authorisation regime for PEPP managers, and common rules on product design and selling practices, to protect customers' best interests. This is intended to complement, rather than replace, national state, workplace and personal schemes.

We believe that the PEPP as a cross-border personal pension product regime with a number of standardised

features could be beneficial in addressing the retirement income gap increasingly faced by many European citizens. As well as providing a standalone portable pension solution, the PEPP could also catalyse complementary national reforms. Ideally national personal pension arrangements should be designed to be compatible with the PEPP to increase flexibility for individual savers.

The near-final text of the PEPP Regulation includes the following 'building blocks':

- **Default investment option:** Providers must offer a basic PEPP with either a capital guarantee at the start of decumulation or a risk-mitigation technique such as life-cycling, which is consistent with the objective of allowing savers to recoup their capital at the start of decumulation. Providers can offer a further five additional investment options to meet the needs of different markets.
- **Cross-border distribution:** Providers must commit to provide compartments of the PEPP in at least two Member States within 3 years of launch.
- **Fee cap:** A fee cap of 1% has been agreed, with further clarification on inclusion costs of distribution, advice and transaction costs (not typically paid to investment providers) to follow. The level of the fee cap will be reviewed on a regular basis.
- **Tax treatment:** Each PEPP should be given the same tax treatment as personal pension products in each Member State.
- **Distribution:** Likely to combine elements of the MiFID, PRIIPs, and IDD disclosure standards, with information provided electronically and free of charge. A Key Information Document will set out the risks, costs and performance of the product, and include a benefit statement. The disclosure presentation, in particular risk factors will have to reflect the multi-decade investment term of the product and the fact that asset allocation will change dynamically over time. Savers invested in a Basic PEPP will be offered advice on a retirement-related demands-and-needs test and the provision of pension benefit projections before conclusion of a PEPP contract.
- **Portability and switching:** Savers to be able to continue contributing to a different 'compartment' of their PEPP if they move between Member States. Switches would be limited to once every five years.
- **Decumulation:** Decisions on retirement age and minimum investment periods before decumulation are left at the discretion of Member States. Savers would have the choice between annuities, lump sums, income drawdown or a combination of all three options to access their savings. Member States are allowed to incentivise specific forms of payment.

- **Approval process:** The PEPP will be approved and supervised by the relevant national supervisor and registered in a central public register maintained by EIOPA. EIOPA has been granted product intervention powers to avoid undercutting of standards at Member State level.

We welcome ongoing discussions to allow the provider's default option to provide lifecycle investment techniques as an alternative to capital guarantees. Guarantees can be expensive to provide and may lead to sub-optimal long term investment allocation decisions, to the detriment of end-investors. While many consumers may want the security of a guaranteed return of capital, we believe many others will benefit in the long term to greater exposure to markets, or a combination of both approaches.

We welcome the recommendation that the PEPP should receive the most favourable tax treatment available under national rules. This will be an important factor for potential PEPP providers before they start to invest in developing PEPPs, and we are keen to see greater clarification as to how and by which Member States this will be applied. This is essential to assessing the economics of administrative platforms required to provide ongoing member reporting and tax reporting and how they can be structured in the most cost efficient way as possible.

## National retirement reforms



### France

Pension reform was a major plank of French President Macron's 2017 election campaign. The Government has set out an ambitious reform of the French pensions system. The reforms are broken into:

- Reform of the 'pay as you go' retirement system (système de répartition)
- The development of supplementary workplace pension savings.

The 'pay as you go' system depends economically on maintaining the balance of employed workers relative to retired workers. Contributions are a percentage of wages, and benefits paid are linked to inflation. The system is therefore dependent on wages growing faster than prices, and continued productivity growth to drive wages and reduce unemployment.

The French public and private sector pensions systems are effectively an unfunded pay as you go system, with a strong element of intergenerational risk transference. We expect proposals for radical reform of the current 'Pillar 1' (state) and 'Pillar 2' (employer) pensions systems by summer 2019,



to encourage user-friendliness and to simplify the system of regimes and entitlements. The process of reform has already involved significant discussions with business and trade unions. The High Commissioner for pension reform, Jean-Paul Delevoye, presented the main aims of the draft legislation at the end of 2018.

President Macron has made it clear that individual rights under existing pensions regimes will be affected by moves towards a single universal coverage regime. However, individuals will benefit from a system which is consistent and simpler to use. To the extent that there will be winners and losers, this will be a controversial reform. While there will be no change to the retirement age of 62 – at which pension rights can be drawn down – full pension rights will only be granted if individuals have a full contribution history. Otherwise they can continue to work to continue to catch up on contribution gaps.

In terms of supplementary workplace savings (Hybrid Pillar 2/3), the 'Loi Pacte', led by Finance Minister Bruno Le Maire, proposes a comprehensive package to promote supplementary defined contribution savings in the workplace. Currently France has a fragmented set of specialist tax regimes for workplace savings. The proposals in the new law launched in June would offer a single regime for supplementary workplace pension savings, including:

- Lifecycling in the accumulation phase, with a high proportion of initial equity allocation. The aim is to encourage long term equity investment, especially in less liquid growth companies
- The ability to access savings during accumulation for a limited number of significant life events
- Decumulation via annuitisation or capital draw down
- Tax advantages for employer contributions

The proposals present a unique opportunity for French savers to benefit from a wider range of long-term investment vehicles, supplementing the existing the pay as you go system (which will continue to represent a fundamental source of retirement income). Outstanding issues on implementation of the Loi Pacte include scheme governance, distribution costs and the design of decumulation solutions.



## Germany

Pension reform has also remained high on the policy agenda for the German government. As reforms to workplace pensions introduced in the previous legislative period take time to deliver results, the focus for the term ahead is revitalising private pensions, as a key element of a three pillar framework.

**State:** An independent Retirement Commission, established in May 2018, is tasked with exploring the options and setting the direction for retirement policy beyond 2025. Given the long-term nature of retirement policy, cross-party support for key reforms is essential, to give individuals confidence that they will not be reversed by the next government. The Commission is currently conducting research and engaging with stakeholders, and will report its recommendations to the Bundestag by March 2020.

**Workplace:** The Occupational Pension Reform Act, which came into effect at the beginning of 2018, provides, for the first time, a framework for firms to auto-enroll employees into Defined Contribution schemes. However, such schemes must be collectively negotiated with trade unions, and this is taking longer than hoped. If progress is not made soon, the Government should consider intervening with further policy action, to avoid a missed opportunity to materially increase participation in workplace pension schemes.

**Private:** The coalition agreement of the new Government expresses the intention to make private pensions more attractive, including the possibility of developing a standardised product under the state-incentivised 'Riester' label. The current requirement of qualifying Riester schemes to offer capital guarantees limits effective asset allocations. Easing this would be a significant first step in improving outcomes and value for consumers.

Since Autumn 2017, work has been underway to develop a model for a three-pillar pensions dashboard, to provide individuals with information that is comprehensive, understandable, reliable, and comparable. Access to a transparent overview of all future income sources will support individuals in identifying whether they have a gap, and what steps to take.



## Netherlands

The four coalition partners making up the Netherlands' government had stated their intention to conclude an accord for a new pensions contract early in 2018 but, at the time of writing, negotiations on a new pensions contract have stalled. Opposite to the government, the unions demand other benefits such as a slower increase of the pension age.

The governing agreement – presented in October 2017 – set out a number of objectives:

- To provide clarity about how a transition from average to age-related 'degressive' pensions accrual would take shape.
- To increase freedom of choice for pension fund participants by introducing the option of a lump sum at retirement.
- To maintain the principal of mandatory participation.

The coalition has promised that the government would contribute to the transition costs – largely as a compensation for the affected participants – to ‘degressive’ pensions accrual (younger employees accruing proportionately more rights than older workers). Costs have been estimated at between €25bn and €100bn. The four parties also said that they would facilitate the collective transition of existing pension claims into individual pension assets, under continued management of pension funds.

The new pensions contract is most likely to comprise individual pensions accrual combined with a certain amount of collective risk sharing, and is to be added to the existing range of pension arrangements.

Importantly, the coalition agreement explicitly stated that the new government rejected additional European pension rules, emphasising that “the pensions system would remain a local competence”. The Dutch government has also consistently maintained a sceptical position towards the development of a Pan-European Pension Product (PEPP).



**UK**

More and more UK citizens are saving for their retirement. Thanks to [auto-enrolment](#), 84% of eligible employees were enrolled in a workplace pension in 2017, up from 55% in 2012.

While this is good news, it is necessary to ensure that people are not just saving, but that they are saving enough to have a comfortable future. Calculations from the Department for Work and Pensions (DWP) [recommend](#) a minimum contribution level of around 12% to 15% of salary. We favour a minimum rate of 15%, and, where achievable, people should be encouraged to reach higher contribution rates of 20% – matching the typical contributions made to private sector Defined Benefit (DB) schemes.

This may be significantly higher than what people are accustomed to, especially given the current trajectory of auto-enrolment towards an 8% contribution rate by April 2019. We believe there is greater potential for auto-escalation techniques such as ‘Save More Tomorrow’ schemes to improve the adequacy of the savings rate. These schemes allow individuals to select a percentage of any future pay increases for investment into their pension pot, meaning that as their salaries increase, so do their savings.

Auto-escalation removes the difficult decision of having to choose whether to save more for a pension, often a lower priority, especially for those saving for a first home, or paying off student loans. Auto-escalation contribution rates could also be adjusted to align with factors such as age, time to retirement, and affordability, helping people to gradually reach the right level of savings. Aligning contribution increases to salary growth, significantly reduces the impact on individuals’ ability to budget and meet existing outgoings, providing more assurance that their pension will be enough for the length of their retirement.

However, saving rates are only part of the challenge: people’s pension investments must also be working hard for them. One innovative investment area for pension schemes is alternative investments. We believe they are an important part of diversified portfolios, given their low correlation to equities and bonds – reducing risk, and improving returns. Less liquid long-term investments such as real estate and infrastructure are especially suited to the long-term profile of DC pension funds, and provide protection against the risk of rising inflation. This will be mutually beneficial for both individual savers and the wider economy.

We therefore welcome the 2018 Budget announcements to review the ‘permitted links’ regime and the structure of the charges cap, which should increase the range of investments available to savers in DC schemes.

The permitted links framework only allows ‘unit linked’ DC schemes to hold investments that are readily realisable (i.e. traded on an exchange). This effectively prevents direct investment in long-term illiquid assets and indirect investments via closed-ended funds that do not have a secondary market. It is important that pension schemes are protected from inappropriate investments, but scheme members should not be prevented from accessing long-term investments to match their long-term horizon. In December 2018 Financial Conduct Authority began [consulting](#) on these rules, with a view to facilitate a wider range of investments for pension schemes.

The structure of the charges cap similarly limits the range of investments available to many savers. Currently, it covers both platform administration fees as well as investment fees. In practise, this ends up leaving very little room for the type of charges and incentive structures that would normally be used in a variety of investment strategies, including the management of illiquid assets. More flexibility in the allocation of costs within the cap would be beneficial to savers because this would facilitate better performance of their investments. We look to feeding into the DWP’s work on this issue when it consults in 2019.

# Market structure

## Evolving equity market structure: MiFID II and beyond

IMPACT	EU market participants and end-investors
January 2018	MiFID II began to take effect.
2019 - 2021	Review and reporting on periodic auctions, consolidated tape, transparency waivers, systematic internalisers regime, cost of market data, and other issues likely to take place.

MiFID II made wide-ranging changes to operations of EU market structure and markets participants. Particular focus points included improving pre- and post-trade transparency in equities, and shifting the equity trading volumes onto regulated, transparent, and centralised trading venues.

Overall, MiFID II has made steps towards improving transparency in EU markets, however more work is needed. We believe bringing transparency up to an even higher standard will mean some aspects of MiFID II – which have sought to shift trading volume onto particular types of venue – will be less important.

As a new EU legislature forms in 2019, we expect to see initiatives looking to further refine the MiFID framework. BlackRock's perspective on reforming equity market structure is guided by maximising the benefit to end-investors. We believe there are five principles policymakers should keep in mind as they look to evolve EU market structure:

1. Promote innovation and encourage fair competition while moderating increasing complexity.
2. Ensure equal and sufficient access to market data.
3. Improve disclosure and investor education.
4. Establish consistent standards for price formation and market resiliency across the equity ecosystem.
5. Ensure applicability of rulesets to ETFs.

With these principles in mind, we encourage regulators to focus future efforts on four areas:

### Delivering a consolidated tape

A consolidated tape of post-trade information discloses equity trade volumes and prices in a timely manner after trades have occurred. Real-time trade information strengthens price discovery, gives an accurate more accurate picture of liquidity across trading venues, and facilitates firms meeting best execution requirements, to the benefit of end-investors.

Despite efforts under both MiFID I and II to bring about a private sector consolidated tape solution, Europe is still lacking in this area. We believe this is due to the commercial

considerations potential providers face: the cost of data processing and cleaning may outweigh the revenue derived from the data. In the US, state-mandated 'Securities Information Processors' are responsible for creating an aggregated view of trading activity. In Europe, we believe ESMA is well placed to take the lead in providing a pan-European consolidated tape solution. Policymakers should consider this in any upcoming review of MiFID.

### European Best Bid and Offer

Regulators could also provide pre-trade transparency via a 'European Best Bid and Offer' (EBBO), equivalent to the US' National Best Bid and Offer (NBBO). This would improve transparency, deliver better public price information to investors, and solve some regulatory market structure concerns.

Currently, some market participants and trading venues use a self-calculated EBBO to inform trade routing decisions. However there is no consensus standard. The lack of a public EBBO disadvantages smaller market participants and investors, for whom connecting to these data sources would be highly costly. This hampers confidence in quoted equity prices, and in obtaining best execution for end-investors.

Going forward, policymakers should further refine EU market structure by introducing an EBBO, taking care to manage any conflicts of interest between public consumers of data and its private providers.

### Market structure that facilitates mid-price executions, contributions to liquidity, and benefits to the end investor

EU policymakers are increasingly focused on shifting trading activity towards venues with high pre-trade transparency (such as traditional stock exchanges and some Multilateral Trading Facilities). The assumption is that prioritising this type of trading will improve transparency and price formation in equity markets. Some non-'traditional' trading venues, such as Systematic Internalisers and Periodic Auction Books – which allow investors with large matching buy and sell orders to trade – will potentially be subject to measures that prevent them from allowing these buy and sell orders to trade at the 'midpoint' price, thereby preventing them from making a saving relative to the respective best bid and ask prices on an exchange. As policymakers consider amendments and clarifications to the MiFID regime, any changes **should allow midpoint executions to take place across all trading venues.**

MiFID II also places direct restrictions on where stocks can trade, notably under the 'Share Trading Obligation' (STO) and Double Volume Cap (DVC). Under the STO shares admitted to trade or trading on EU markets can only be traded on EU trading venues, or on 'third country' (non-EU) trading venues in countries deemed equivalent by the EU based on total trading volume across the previous twelve months.

The DVC restricts the volume of a stock that can trade in venues without pre-trade transparency at 4% per individual venue, and 8% across all venues in the EU.

The STO has created some confusion over whether shares with primary listings outside of the EEA must be traded on EEA venues. In some cases, this could force firms trading non-EEA stocks to execute trades away from the primary, lower-cost source of liquidity, to the detriment of EU investors. We recommend that regulators clarify that STO should be limited only to stocks with significant liquidity in the EEA.

The DVC (and other restrictions on trading venues without pre-trade transparency) assume that these venues unduly harm price formation and do not contribute to liquidity provision. We believe this is incorrect, and that regulators should take a less direct stance in trying to shift liquidity from dark to lit markets, and reframe the debate on the contributions to liquidity and benefit to the end-investor (and in turn the Capital Markets Union).

### Market resiliency mechanisms

MiFID II introduced requirements for trading venues to have controls in place that ensure market resilience during periods of stress – for example halting trading for certain equities. Importantly, however, it did not specify the mechanisms required, leading to fragmented approaches to market controls across the EU. Experience in the US has shown that market resiliency mechanisms that are not properly harmonised and calibrated with one another can worsen market stress.<sup>1</sup> We therefore urge the adoption of minimum and consistent market resiliency standards across European markets, in particular:

- Automated controls should be a basic requirement for trading venues.
- Opening auctions should have staggered standardised thresholds (for example 5%, 10%, or 15%), based on the underlying volatility of the security, ensuring that methodologies are robust and disclosed.
- Intra-day volatility auctions (i.e. stock-specific halts) should be an additional feature of all trading venues, and standardised across venues.
- Trade cancellation policies (similar to CEE policies in the US) should be aligned with any volatility auction process and should not occur within volatility thresholds.
- Resumption of trading after a pause or halt requires as much consideration and calibration as those that trigger them.

## LIBOR reform

IMPACT	Financial services industry at large; corporates; retail and institutional investors
SEP 2012	Wheatley Review of LIBOR Final Report published.
JUL 2013	IOSCO Final Report on Principles for Financial Benchmarks published.
JUL 2014	FSB released Final Report on Reforming Major Interest Rate Benchmarks.
JUN 2016	EU Benchmark Regulation finalised.
JUL 2017	FCA announced it will not compel panel bank submissions as of end-2021.
JUL 2018	The first over-the-counter swaps linked to the new US secured overnight financing rate (SOFR) traded and cleared.

The future of LIBOR (the London Inter-Bank Offer Rate) is in doubt post-2021. Following the 2012 rate-fixing scandals, substantial improvements have been made to what was once called the “world’s most important number”, a benchmark used as a reference rate in a wide range of wholesale and retail financial products, the total notional outstanding value of which once exceeded USD 240 trillion.

Since then, activity in the market on which LIBOR is based – unsecured interbank term borrowing – has declined substantially. Following the financial crisis, banks have shifted away from unsecured short-term borrowing, preferring repos, bonds and other forms of financing. Post-crisis liquidity rules, which treat interbank borrowing as unstable, have reinforced the trend.

The dialogue has at the same time shifted from reform to pre-existing rates such as LIBOR and EURIBOR to replacement with Alternative Reference Rates (ARRs). These include Secured Overnight Financing Rate (SOFR) in the US, a reformed Sterling Overnight Index Average (SONIA) in the UK, and the Euro Short Term Rate (ESTER) in the Eurozone. The catalyst for this change was a July 2017 speech by Andrew Bailey, Chief Executive of the UK FCA, indicating that submitting to LIBOR will no longer be required of panel banks after 2021. While this does not mean that LIBOR will disappear in 2022 (or ever), market participants must carefully consider the implications of benchmark reform for their portfolios.

Planning for the future begins with awareness. But awareness alone is not a plan. The market is only now

1. See our 2015 *ViewPoint – US Equity Market Structure: Lessons from August 24*, available at: <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-us-equity-market-structure-october-2015.pdf>

engaged to deliver a comprehensive transition plan for the trillions of dollars of outstanding LIBOR-related transactions that will not mature before 2022. These exposures expand far beyond derivatives markets, as LIBOR is a prevalent reference rate embedded in many types of floating rate instruments, including mortgages and loans. With the identification of ARRs mostly behind us, investors and regulators must now turn their attention to addressing legacy positions in a coordinated manner across asset classes and currencies.

In 2019, BlackRock will continue to engage with policy makers and the market to raise awareness that:

- Global coordination across currencies and asset classes is critical.
- Our principal concern is the management of existing positions that reference LIBOR. In USD LIBOR alone, at least \$36 trillion in outstanding notional will not mature prior to 2022.
- The ARRs identified are not direct substitutes for LIBOR. The differences need to be considered as market participants decide whether to adopt them.
- The market will ultimately determine the pace of ARR adoption based on liquidity and the compatibility of ARRs with various asset classes.
- Financial transactions do not exist in isolation. The relationships between assets in a portfolio must be handled with care to avoid disruption.
- Greater education of end-users is needed. This is integral to broader awareness and market readiness.

We are committed to making sure the investor voice is heard in this discussion. Given the complexity of the use of LIBOR, BlackRock is currently assessing the impact to its use within portfolios and financial instruments including products traded, use as a reference index, valuation, accounting and liquidity and will be developing a program to minimise any impact to client portfolios.

## Clearing

### Securities Financing Transactions Regulation

IMPACT	Asset managers - UCITS investment companies and AIFMs in relation to the obligation to publish their use of SFTs in their half-yearly and annual reports
JAN 2014	European Commission proposal published.
JAN 2016	Entry into force of Level 1 text (except for provisions subject to phased in implementation).
JUL 2016	Entry into force of transparency requirements on re-use of collateral.
APR 2017	ESMA final advice to the EC on the Regulatory Technical Standards on reporting of SFTs to TRs.

DEC 2018	European Commission endorsement of the reporting RTS.
Q1 2019	Regulatory Technical Standards expected.
Q2 2020	Phasing-in of reporting to Trade Repositories expected to begin.

In 2011, the Financial Stability Board (FSB) began its work on 'shadow banking' (i.e. financing not provided by credit institutions), identifying securities financing transactions (SFTs) as sources of financing that could be provided in parallel to traditional banking, but that required better regulation. The term "shadow banking" is often confused with market-based finance, which has since been rebranded by the FSB as 'non-bank financial intermediation'.

Broadly speaking, SFTs are transactions where securities are used to borrow cash or other securities. They include securities lending, repurchase agreements (repos), and other collateralised operations consisting of a transfer of ownership.

In January 2014, the European Commission published its proposal to regulate the reporting and transparency of SFTs. The subsequent Securities Financing Transactions Regulation (SFTR) is part of the EU's implementation of the global effort made to regulate shadow banking and covers three key requirements: transaction reporting, disclosure obligations, and collateral re-use obligations.

The disclosure and collateral reuse obligations are currently in force. Transaction reporting is expected to be phased in from Q2 2020. All securities loans, repos, reverse stock loans, buy and sell back arrangements and similar operations will need to be declared to an EU trade repository. Additionally, transactions that occur under EMIR and MiFID must be declared, as part of a general move to increase transparency in capital markets.

Costs linked to the new disclosure requirements for the buy-side are not to be underestimated, and may influence their use of SFTs and subsequently the flow of collateral in the financial system.

### Key features of the Securities Financing Transactions Regulation

- SFTs must be reported to an EU-approved trade repository.
- Management companies of UCITS and AIFs must inform investors of their use of SFTs, as well as other financing structures, in timely reports.
- Collateral must be credited to the receiving counterparty's securities account prior to its re-use by that counterparty. This provision applies to all collateralised obligations, not only to SFTs, each time the receiving counterparty has a right to re-use.

## European Market Infrastructure Regulation REFIT

IMPACT	Asset managers; retail and institutional investors
AUG 2012	The Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (known as 'EMIR' - European Market Infrastructure Regulation) entered into force.
2015-16	EMIR Review took place.
MAY 2017	Proposal for a Regulation to address disproportionate compliance costs, transparency issues and insufficient access to clearing for certain counterparties arising from EMIR ('EMIR REFIT') published.
OCT 2017	European Central Bank publishes its opinion on the proposal.
DEC 2017	Council position agreed.
JAN 2018	European Parliament position agreed.
JUN 2018	Trilogue negotiations began.

The European Market Infrastructure Regulation (EMIR) is the EU's response to the G20 commitments on increasing transparency in derivative contracts traded over-the-counter (OTC derivatives) agreed in September 2009.

The regulation is completed by several delegated acts and by equivalence decisions recognising third-country CCPs.

A review of EMIR conducted between 2015 and 2016 concluded that EMIR's core requirements should not be changed, but that specific areas could be amended to eliminate disproportionate costs and simplify rules.

The subsequent 2017 EMIR REFIT proposal:

- Put forward the principle of providing clearing services under fair, reasonable and non-discriminatory ('FRAND') commercial terms;
- Set out a new method of calculating positions to determine whether a financial counterparty is subject to the clearing obligation;
- Would give the European Commission the power, in exceptional circumstances, to temporarily suspend the clearing obligation for a specific class of OTC derivatives or type of counterparty;
- Exempt intra-group transactions involving non-financial counterparties from the reporting obligation;
- Oblige central counterparties (CCPs) to provide their clearing members with tools to simulate their initial margin requirements; add requirements to ensure the quality of reported data for trade repositories (TD);
- Increase the upper limit of fines for infringements of EMIR by TDs; and provide for a three-year exemption from central clearing for pension funds.

From the perspective of the end-investor, BlackRock has made recommendations to policy makers to focus on the following issues within the context of the EMIR REFIT:

- **Reporting:** extend the move to single sided reporting across the EMIR regime to facilitate comparability and global alignment.
- **Scoping issues:** clarify the intention behind broadening the scope of financial counterparties to include all AIFs irrespective of domicile; assess unintended and materially adverse consequences of including securitisations.
- **Capital charges:** align capital charges related to clearing to incentivise additional clearing participants, liquidity, and netting efficiencies.
- **Alignment of UCITS with EMIR:** amend UCITS to take into account the clearing obligation for certain types of OTC financial derivative transaction under EMIR.

At the time of writing, a general approach on the file is expected on this proposal in early 2019.

### Key features of the EMIR REFIT

- Central clearing of standardised OTC derivative contracts; margin and operational risk mitigation requirements for OTC derivative contracts that are not centrally cleared.
- Reporting obligations for derivative contracts.
- Specific requirements for central counterparties (CCPs) and trade repositories (TRs).

### CCP Recovery and Resolution

IMPACT	Financial services industry at large; corporates; retail and institutional investors
NOV 2016	EU proposal for a Regulation on a framework for the recovery and resolution of central counterparties published.
JUL 2017	CPMI-IOSCO Revised Report on CCP Recovery of Financial Market Infrastructures published.
JUL 2017	FSB Guidance on Central Counterparty Resolution and Resolution Planning published.
SEP 2018	Nasdaq Clearing member default took place.
OCT 2018	Basel Committee on Banking Supervision published consultation on 'Leverage ratio treatment of client cleared derivatives'.
NOV 2018	FSB published discussion paper on 'Financial resources to support CCP resolution and the treatment of CCP equity in resolution'.

Clearing mandates and market incentives have successfully migrated a significant volume of OTC derivatives into clearing, which together with legacy exchange traded products, create significant exposures to Central Counterparties (CCPs) across the globe. We are also beginning to see meaningful efforts to move securities financing into a cleared market structure.

These efforts have all been to leverage the robust risk mitigation provided by CCPs through their use of margin and risk mutualisation. However, while CCPs reduce credit risk, it is important to recognize that risk is not eliminated, which was demonstrated by the September 2018 CCP member

## Brexit and Clearing

Two important policy issues regarding Brexit and clearing remain outstanding going into 2019. The first concerns the possible fracturing of liquidity into UK and EU pools in the event of a “hard Brexit” (i.e. where there is no deal on the future EU-UK relationship on financial services) and denial of access to 3rd country firms to liquidity pools and clearing facilities. The second, and critically important issue that will remain at the top of the policy agenda in 2019 is to ensure legal consistency regarding the status of contracts based on UK law through Brexit and a subsequent transition period.

### Access to central clearing

In June 2017, the European Commission published a proposal on the oversight of third-country CCPs and Euro-denominated clearing activities (so called “EMIR 2.0” proposal). The proposal sets out to ensure further supervisory convergence and accelerate certain procedures regarding CCPs. The proposal also provides for closer cooperation between supervisory authorities and central banks responsible for EU currencies. Most controversially, the proposal introduces a new ‘two-tier’ system for classifying third-country CCPs. Non-systemically important CCPs will continue to be able to operate under the existing EMIR equivalence framework. However, systemically important CCPs will be subject to stricter requirements.

Depending on the significance of the third-country CCP's activities for the EU and Member States' financial stability, a limited number of CCPs may be of such systemic importance that the requirements are deemed insufficient to mitigate the potential risks. In such instances, the European Commission, upon request by ESMA and in agreement with the relevant central bank, can decide that a CCP will only be able to provide services in the Union if it establishes itself in the EU, thereby introducing the possibility of a de-facto location policy for derivatives and swaps denominated in Euro.

As a fiduciary to our clients, BlackRock has engaged with policy makers to make the case for maintaining the advantages of an efficient, open, multi-currency clearing environment for the global OTC derivatives markets. Currently global liquidity in a number of important

loss allocation at Nasdaq Clearing. While the probability of a CCP failure is low, it is not zero. CCPs are businesses that can fail and CCP rulebooks are increasingly incorporating loss sharing mechanisms that impact the end-investor.

financially products, such as Interest Rate Swaps, is found in London. Counterparties throughout the EU today benefit global liquidity, but the effect of the proposals from the Commission could see that fractured if EU27 counterparties are barred from using clearing houses in London post-Brexit.

There remain some very real concerns in respect of the impact of a location policy on financial stability, liquidity, the cost of trading, and counterparty concentration risk, which could be detrimental to end-investors. In our view, the economic and regulatory rationale for restricting clearing of Euro-denominated derivatives transactions to the Eurozone has yet to be convincingly made. Irrespective of the outcome of the high level settlement on Brexit, a focus on what is best for end-investors would help policy makers choose a workable path forward in this technical but systemically significant aspect of the Brexit debate.

### Contract continuity

The contractual continuity issue arises because, after Brexit, it is assumed that UK and EU-27 regulated firms will no longer benefit from the single market passport which currently allows them to engage in regulated activities in the EU-27 and the UK respectively without the need for an additional local licence. This raises issues for certain longer-dated OTC derivative contracts, which were entered before Brexit, when the entity held the relevant passport, but where the contract continues beyond Brexit. In such cases, some so-called ‘lifecycle events’ that arise during the life of the contract may be regarded as constituting regulated activities in the jurisdiction where the client or counterparty is located, thereby triggering the application of local licensing requirements if the firm retains those contracts after Brexit.

In December 2018, the European Commission announced measures aimed at mitigating these risks in relation to legacy cross-border contracts. The Commission has also stated it will recognise UK-based CCPs as equivalent under EMIR for 12 months, in the event of a no deal Brexit. This gives firms more time to run off, transfer or terminate affected contracts. This is a welcome development, which ensures that end-users of CCPs, such as pensioners and retail end-investors, do not suffer as the result of a political failure to reach an agreement on Brexit.

The structure of cleared markets also creates a complicated risk profile for the end-investor, who faces risk at the level of the CCP, and of the clearing member (bank) through which the investor accesses clearing services. As clearing continues to progress, market participants and supervisory authorities need to recognise and address these risks accordingly.

End-investors have a direct interest in ensuring an effective and fair regime for recovery and resolution of CCPs without resorting to a taxpayer bailout. An effective regime for central clearing strengthens investor confidence underpinning financial stability. A loss of confidence leads to reduced investment and could cause investor flight, exacerbating a crisis. The default of a Nasdaq clearing member in 2018 that resulted in a material loss allocation to members has reinforced several concerns in this regard. Specifically:

- CCPs should have more capital at risk to better align incentives and provide a meaningful layer of loss absorption to support its markets.
- Disclosure standards for CCPs are not sufficient. CCPs should be subject to more comprehensive disclosure requirements that would ensure accuracy and consistency of information provided.
- Initial margin models need to be consistently calibrated to cover risk, regardless of where a contract is traded (OTC vs. exchange traded).

In this context we remain concerned by the potential allocation of losses to end-investors without sufficient oversight by a relevant authority. Many CCPs have the authority, within their rulebooks, to use variation margin gains haircutting (VMGH) to allocate uncovered losses (beyond the member loss mutualisation and CCP dedicated resources) to end-investors in order to continue operating. We are concerned that this does not create the right incentives for investors to maintain their positions during a time of stress and is therefore potentially systemically destabilising. End-investors who fear they could be subject to losses inappropriately allocated to them through VMGH would rush to the exit and rationally seek to rapidly close out positions. At a minimum, we believe there needs to be controls and restrictions on VMGH, with no room for ambiguity. Strict controls and caps, as well as transparency on maximum potential exposure to losses, must be placed around potential use of VMGH.

We continue to urge policy makers to establish the following framework for VMGH in CCP recovery and resolution legislative proposals:

- VMGH should never be available to a CCP as a recovery tool, but should only be available to resolution authorities. Despite opposition from many market participants, CCPs routinely incorporate VMGH into their rulebooks.
- VMGH losses should be capped by an absolute amount and/or limited to one round of haircutting to allow for appropriate measurement and management of CCP risk exposure.
- VMGH losses incurred by end-investors should mandatorily be shared with clearing members to ensure full alignment of interests of stakeholders towards prompt and effective resolution of the CCP.
- Participants subject to VMGH should receive a senior claim against the CCP and its successors for the full amount of the variation margin taken from them in the same way a CCP would hold a claim over defaulting members.

Policy makers should continue to focus on CCP resiliency while they further address the incentives introduced by the current state of recovery and resolution plans, which, in our view, allow CCPs to unfairly allocate losses to end-investors.

## Exchange Traded Funds

IMPACT	Asset managers; retail and institutional investors
DEC 2012	ESMA published guidelines on ETFs and other UCITS issues.
JUN 2013	IOSCO published Principles for the Regulation of Exchange Traded Funds.
MAY 2017	The Central Bank of Ireland (CBI) Discussion Paper (DP6) on ETFs published.
OCT 2017	The French market regulator (AMF) updated policy for ETFs.
SEP 2018	The CBI published a Feedback Statement on DP6.
DEC 2018	MiFID II <i>Ex Post</i> regulatory costs disclosures published for the first time.
DEC 2018	European Parliament's Economic and Monetary Affairs committee voted to review regulatory transaction cost methodology, and to extend the UCITS exemption in PRIIPs to the start of 2022.



In September 2018, the Central Bank of Ireland (CBI) issued a 'feedback statement' on its May 2017 discussion paper on Exchange Traded Funds (ETFs). Through this process, the CBI has established itself as a thought leader on ETFs, in the context of broader ESMA and IOSCO deliberations around possibly updating and upgrading relevant EU rules and global standards in 2019.

Many of the findings and interim conclusions in the Feedback Statement align with BlackRock's views around how the industry can and should evolve from the product perspective. Specifically, we agree that daily transparency of the underlying securities in an ETF is the most effective means to ensure that the price stays in line with the underlying holdings. We also agree that having hedged and unhedged share classes with different cut-offs should be permitted and that 'fair' treatment does not equate to 'equal' treatment so listed and unlisted share classes should be permitted within the same fund.

Regarding ecosystem resilience, a topic which has been a key focus of policy makers, like the CBI, globally for a number of years, BlackRock advocates a multi counterparty / multi Authorised Participant (AP) model (although we do not believe regulators should stipulate minimum or maximums). The CBI has advocated disclosure of APs and Official Liquidity Providers ('OLPs') as well as market making agreements between issuers and OLPs. While we have no fundamental objections to disclosing the names of our APs and OLPs (which are often disclosed by stock exchanges), we question what the benefit would be. In fact, naming APs and OLPs (official liquidity providers) could create an impression they are the only ETF liquidity providers. We also question the benefit of publicly disclosing commercial arrangements such as market making agreements.

BlackRock has long called for regulators to take a more proactive approach in two specific areas of ETF regulation, the first being around the development of a pan-European Consolidated Tape for ETFs, which would take effect in Europe by amending existing MiFID II / MiFIR rules. While BlackRock welcomes the additional post-trade transparency afforded by MiFID II, the lack of a consolidated data feed means that end-investors are unable to benefit from a complete view of pricing and trading volumes for ETFs in Europe (see [page 19](#)).

We also believe that a clear classification framework to help investors better distinguish ETPs with more complex and higher risk structures (e.g. leveraged products) from traditional ETFs and risks across product types is necessary. February's market volatility led to the rapid price collapse of certain leveraged and inverse volatility-related exchange traded products, a number of which were held by retail investors. A clear classification system could have better informed these investors about the risk inherent in some of these non-standard ETPs.

In 2019, the CBI will continue to influence the global discovery work that IOSCO is leading. This work doesn't have an end-date but a likely outcome would be a revision of IOSCO's 2013 Principles for ETFs. Regulators globally are currently considering if specific policy work is necessary to address:

- Whether investor expectations are managed appropriately through Exchange Traded Product (ETP) classification, naming and the suitability of more complex strategies for retail investors.
- Investor awareness around ETF trading costs and the usefulness of portfolio disclosure to investors.
- A broader set of issues which will include the selection and monitoring of APs, role of index providers and how they are monitored, managing potential conflicts of interest between parties and the challenges of fragmentation where ETFs listed or traded on multiple exchanges.

Importantly, this is an agenda the ETF industry generally supports. There are also a number of steps, for example around ETP classification that the industry can take together to better protect retail investors and to strengthen ecosystem resilience. This agenda will be a key area of focus for BlackRock through 2019.

Another area in which BlackRock has been calling for clarity is on regulatory cost transparency. Early signs support the hypothesis that MiFID II is creating a virtuous cycle of growth and demand in the European ETF industry - driving awareness about ETFs as a way to invest across asset classes and geographies, by shining a light on costs, and the scale of trading and liquidity.

The first client statements with detailed ex post breakdowns of costs and charges will start to appear from January 2019. This marks a crucial milestone for the European industry, as it will:

- drive greater awareness of current and legacy charging practices.
- cause investors to scrutinise the true sources of return in their portfolios and the most efficient tools to achieve portfolio outcomes.
- invite greater scrutiny on value for money.

This is expected to intensify the shift to fee-based advisory models, levelling the playing field for ETF usage.

However, the full impact of regulatory costs transparency will only be achieved once the rules are implemented consistently across Europe and product manufacturers adopt the same methodology to calculate published transaction costs. Until then, investors will continue to struggle to make meaningful comparisons between different providers' products.

We welcome the recent confirmation from the European Parliament that they have called on the Commission to review the regulatory transaction costs methodology (i.e. PRIIPs/slippage) and to extend the UCITS exemption (for roll out of PRIIPs KIDs to UCITS) by a further two years to the start of 2022. This is a significant step forward, as it recognises the industry’s concerns and facilitates the full debate on costs we have been calling for. Most importantly, it is good for investors in UCITS funds, as it means asset managers will not have to provide a sub-standard disclosure document to them, until it has been improved (see [page 12-13](#)). BlackRock will continue to drive industry and policymaker engagement on this in 2019.

## Taking market based finance out of the shadows

### Measuring leverage in the asset management sector

IMPACT	Asset managers
JAN 2017	FSB published 14 final Policy Recommendations to Address Structural vulnerabilities for Asset Management Activities including a call for simple measures of leverage within investment funds.
NOV 2018	IOSCO released a consultation on simple measures on leverage.
2019	Final IOSCO recommendations on leverage expected.

In 2017, the Financial Stability Board (FSB) tasked the International Organisation of Securities Organisations (IOSCO) with developing measures of leverage to collect a greater amount of quality data, to enable authorities to better monitor and compare leverage across investment funds. The FSB recommended that:

- IOSCO develop simple and consistent measure(s) of leverage in funds that allow authorities to meaningfully monitor and compare leverage.
- National authorities collect data on leverage in funds, and monitor leverage in funds without leverage limits, or that are perceived to pose risks to the financial system.
- IOSCO collect national and regional aggregated data across member jurisdictions on the measure(s) it develops.

In November 2018, IOSCO began to consult on a proposed approach. At ‘Step 1’, IOSCO suggests a combination of three measures consisting of Gross Notional Exposure (GNE – the total notional value of a funds derivatives and its other investments), Adjusted GNE (adjustments reflecting

interest rates an options equivalent to certain bonds) and Net Notional Exposure (NNE – reflecting derivative positions that eliminate some or all of the risk in other positions or investments such as netting). In ‘Step 2’, IOSCO suggests local regulators should consider other factors to determine which funds captured under Step 1 should be assessed further. Supplementary analysis could consider fund portfolio composition, or ability to meet margin calls, among other factors.

Further work is needed to understand their interaction with existing European reporting requirements for UCITS and AIFs.

BlackRock supports the use of multiple measures of leverage at Step 1. There is no one measure which encapsulates leverage and risk across the heterogenous range of funds and assets classes available to investors. GNE can be used to determine which funds use derivatives but does not measure economic exposure, leverage, or risk. Nor does it allow comparison across funds. Relying on GNE alone may generate misleading conclusions about the risk exposure of a fund. We support the approach of adjusting GNE to take into account interest rate derivatives and options, and reporting by asset class to allow comparison. NNE, which takes into account netting and hedging (i.e. reduction of economic exposure) also helps provide a greater understanding of real economic exposure. Further work is also needed to understand the interaction of (adjusted) GNE and NNE with existing European reporting requirements for UCITS and AIFs.

At Step 2, any additional measures of leverage should recognise that leverage is managed at fund level, that funds are separate legal entities, and that the assets of one fund cannot be used to meet the liabilities of another. The objective of reviewing leverage data should be to filter out funds and strategies on a number of verifiable grounds, permitting regulators to focus on the funds with the largest potential for systemic risk.

Prudently managed, the use of leverage can be beneficial to end-investors. The use of leverage, whether for investment exposure or for hedging, varies between funds, and the ability of funds to use leverage is limited by their core investor base.

For more detailed analysis, see our forthcoming response to the IOSCO Consultation, available in February 2019.

### Oversight of fund liquidity in Europe

We continue to see discussions at the European level on the oversight of fund liquidity.

In January 2018, the European Systemic Risk Board (ESRB) published Recommendations for EU legislators and

regulators to address liquidity and leverage in investment funds. The Recommendations looked at liquidity and leverage risk management at the level of both fund managers and the wider financial system: they proposed a regulatory framework for fund liquidity management and stress testing, legislation to allow regulators to suspend fund redemptions, and legislation to limit 'liquidity transformation' in certain fund types. We addressed these proposals in the [2018 edition](#) of our Regulatory Developments in Europe *ViewPoint*. In parallel, ESMA is coordinating work by European securities regulators to update its Guidelines for liquidity stress testing for investment funds.

The conversation on regulation of liquidity risk has continued, with a more recent European Central Bank (ECB) Study on Macroprudential liquidity tools for investment funds.<sup>2</sup> The Study suggests 'investor runs' are a 'key risk' in open-ended funds, and could pose a threat to financial stability; particularly where funds have liquidity mismatches between assets and redemption terms, or employ leverage.

Macroprudential measures discussed by the ECB include:

- Mandatory liquidity buffers, which would require funds to hold high-quality liquid assets to meet outflows in stressed periods, making them more resilient to, for example, margin calls or investor redemptions in times of market stress.
- Redemption duration restrictions in order to align investor liquidity with that of the funds' assets. This could be differentiated based on the funds' asset types or use of leverage.
- Authorities' power to suspend redemptions, a targeted measure requiring fund managers to suspend redemptions, in cases where the cost to investors of lost access to liquidity was proportional to financial stability gains.

In the first instance, it is important to note that redemptions from investment funds are not equivalent to 'run risk' faced by banks and bank-like entities.

The latter purchase assets by issuing short-term liabilities to 'run' prone investors, meaning they can become forced sellers in periods of distress. Conversely, investment fund shares purchase their assets with redeemable equity; the value of these shares fluctuates with the value of the assets, and so unlevered funds do not face material asset-liability mismatches. Additionally, investment funds have mechanisms in place to avoid becoming a forced seller: in worst-case-scenarios where funds cannot meet redemptions in the expected timeframe, funds can suspend redemptions or apply gates.

Regarding the measures proposed by the ECB, in our view:

Required liquidity buffers are unlikely to be an effective solution for dampening the effects of asset sales. In practise, they would lead to pro-cyclical outcomes as funds are encouraged to sell less liquid assets in order to maintain their required buffers. Instead, regulators should focus on developing risk management standards, and expanding the toolkit of backup measures available to funds.

Regulatory interventions into fund redemption mechanisms are also likely to be counter-productive, and also raise questions of fairness. If fund investors are prohibited from redeeming their shares, they will likely sell other assets not subject to redemption restrictions, such as direct investments. Further, investment fund holdings represent a minority of financial assets: this limits the effectiveness of mandatory redemption gates as a systemic risk mitigant, and also creates fairness issues, as fund shareholders are unable to sell assets that other asset owners can.

For more detailed analysis, see our *ViewPoints*: [Macroprudential Policies and Asset Management](#), and [Taking Market-Based Finance Out of the Shadows](#).

## Investment Firm Review

IMPACT	<b>MIFID investment firms such as broker-dealers, principal traders asset managers, corporate finance houses and investment advisers</b>
DEC 2017	Commission proposals for an Investment Firm Directive (IFD) and and Investment Firm Regulation (IFR) published.
SEP 2018	Parliament finalised its negotiating position
JAN 2019	Council finalised its negotiating position
JAN 2019	Trilogue negotiations began

The Investment Firm Directive (IFD) and Review (IFR) were published in 2017 after nearly 2 years of detailed assessment and review of the current prudential regime for investment firms.

Under these proposals, firms which engage in underwriting of securities and dealing on their own account, with a balance sheet in excess of €30 billion, will be treated as 'systemically relevant' Tier 1 firms, and subject to regulation as credit institution Single Supervisory Mechanism oversight.<sup>3</sup> Small firms with client assets under management (AUM) of less than €1.2 billion will be treated as Tier 3 firms and all other firms as Tier 2 firms.

2. ECB (2018) *Macroprudential liquidity tools for investment funds – A preliminary discussion*, available at: [https://www.ecb.europa.eu/pub/macprudential-bulletin/html/ecb.mpbu201810\\_03.en.html](https://www.ecb.europa.eu/pub/macprudential-bulletin/html/ecb.mpbu201810_03.en.html)

3. The EU's Single Supervisory Mechanism for large banks

The proposals also recognise that firms need to be able to set their own level of fixed and variable remuneration without a cap to be able to respond to volatility in revenue streams.

We welcome the move away from a bank-based model of prudential regulation for Tier 2 and 3 firms, which aims to provide a more proportionate capital regime for the majority of firms not in Tier 1. It will also put “an end to the complicated task of matching and reconciling business data to an ill-fitted regulatory framework and reporting regime.”

The capital requirements are based around risks to clients, risk to the firm, and risk to markets – the so-called ‘K-Factors’. For asset managers, the key risks relate to client AUM and order handling. This means capital requirements for asset managers continue to grow in line with the new business and the type of activities they engage, while recognising that clients assets are typically segregated with

a third party custodian or depositary, and therefore fully protected in the case of default or insolvency of the manager.

#### Key features of the Investment Firm Directive:

- A simpler categorisation of investment firms in a manner that captures their different risk profiles.
- A set of prudential rules, notably on capital, liquidity, remuneration and governance requirements, that are appropriate to the specific risks that investment firms are exposed to and that ensure that capital is assigned to where it is needed.
- A framework that corresponds to the risks inherent in the nature and range of activities undertaken by investment firms.
- A streamlined supervisory and reporting toolkit.

## Reforming EU money market funds

IMPACT	All EU-domiciled money market funds – both prime and government funds
SEP 2013	European Commission proposal for a MMF regulation published.
NOV 2016	Agreement between Parliament and Council announced.
JUN 2017	MMF Regulation published in the Official Journal of the EU.
NOV 2018	Publication of ESMA’s final report on technical advice, draft implementing technical standards and guidelines under the MMF Regulation.
JUL 2018	New funds (established after 20 July 2017) must comply with MMF Regulation by 21 July 2018.
JAN 2019	Deadline for existing funds (established before 20 July 2017) to comply with MMF Regulation by 21 Jan 2019.
21 MAR 2019	‘Reverse Distribution’ no longer permitted for EU MMFs

New EU rules for Money Market Funds (MMFs) are taking full effect for all EU-based MMFs in January 2019. The MMF Regulation (MMFR) was agreed at the end of 2016 after over 3 years of debate at the legislative level. It aims to enhance the liquidity and stability of MMFs, following the financial crisis of 2007. As in the US, new rules over the permissibility of Constant Net Asset Value (CNAV) fund structures were at the centre of the reforms.

In addition to providing rules for Variable Net Asset Value (VNAV) MMFs, the MMFR creates two new types of MMF in Europe: Public Debt CNAV MMFs and Low Volatility Net Asset Value (LVNAV) MMFs. A Public Debt

CNAV MMF must invest 99.5% of its assets in government securities and maintain a constant NAV, while LVNAV MMFs are more sensitive to market pricing at both the asset and fund level, but can allow investors to subscribe and redeem to and from the fund at a constant share price of 1.00 in normal market circumstances.

2018 saw a protracted debate over whether or not the practice of share cancellation – sometimes referred to as the ‘reverse distribution mechanism’ (RDM) – would be permitted under MMFR. RDM is the mechanism used to distribute the negative income generated by portfolios where the yield is negative (most prominently, euros). MMFs funds must distribute all income in order to maintain a constant share price of 1.00. By blocking their ability to distribute income, an RDM prohibition would mean that Public Debt CNAV and LVNAV funds, where the portfolio yield is negative, would be unable to maintain a constant share price – negating a key feature of the funds.

Early in 2018, the European Commission expressed an opinion that RDM should be understood as incompatible with MMFR and asked ESMA to clarify that the practice should be banned. The discussion continued throughout the year, with an exchange of letters between ESMA and the Commission in July and October, respectively. As a result of the ongoing uncertainty, some national competent authorities (NCAs) refused to approve new prospectuses containing RDM, and were only able to clarify in late 2018 that the Commission’s opinion would be taken into account. Because of the short timeframe to convert funds affected by the RDM ban, NCAs have allowed the conversion of these funds into MMFR funds to be delayed to 21 March.

## Brexit: where next?

Following the rejection of Theresa May's Brexit deal by the UK Parliament on 15th January, the UK has entered an acute phase of political uncertainty. The prospect of a no-deal Brexit remains a real possibility, and both the EU and the UK are ramping up their planning for such a scenario. In the area of financial regulation this has included measures by both sides that attempt to smooth the so-called 'cliff edge' risks, such as the EU's temporary equivalence decisions for CCPs, the UK's 'Temporary Permissions Regime' guaranteeing continued market access, and undertakings between the European Supervisory Authorities, EU27 National Competent Authorities, and their UK counterparts indicating a willingness to ensure co-operation agreements and MoUs are in place in the event of no-deal.

### Into the implementation period

Nevertheless, it is in the interests of all sides that no-deal is avoided, and a deal of some kind is eventually agreed. If this happens, the UK will enter into an implementation or transition period at the point of exit, during which the UK's trade and regulatory relationship with the EU will remain as it is now until at least 31st December 2020. Thereafter, this period will either be extended for a maximum of two years; the UK will enter into the Northern Ireland 'backstop' arrangement, and a de facto 'bare bones' customs union between the UK and EU, or the new 'Future Relationship', will come into force.

### Towards the future relationship

The Political Declaration agreed last year set out the framework for the future relationship between the UK and EU, but says little about financial services. While it notes that both sides are committed to "preserving financial stability, market integrity, investor and consumer protection and fair competition", the "regulatory and decision-making autonomy" of both is asserted. This rules out the kind of market access regime based on mutual recognition which many financial services firms were hoping for.

Instead, EU and UK market participants' access to each other's markets will depend on the independent decision-making of their respective authorities. Unless a more

ambitious arrangement can be negotiated within or parallel to the 'future relationship,' this will be based on the unilateral operation of the equivalence regime operated by the EU, which the UK has adopted in full, and will apply to EU countries in the future.

### Enhanced equivalence?

The current form of equivalence has a number of drawbacks, in terms of both the scope of activities for which equivalence determinations are available, and the processes through which it is assessed, granted, and reviewed. The Political Declaration talks about enhancing processes to address some of these shortcomings, however there is no consensus between the UK and EU authorities on what such enhancement should mean. While the UK side envisages a more predictable, expanded and outcomes-focused equivalence regime, the European Commission is focused on calibrating requirements for acceptance of EU rules and supervisory oversight with the systemic significance of the activities concerned.

### A less predictable future?

This could point to a much stricter regime for activities in non-EU countries, including the UK, which hosts the vast bulk of European capital market activity, raising questions about the extent to which the UK authorities would tolerate strict rule-following and/or joint supervision as a price worth paying for market access. The UK is of course a considerable market in its own right, and interdependence between the EU and UK in areas such as clearing is significant. This is the backdrop against which both sides will operate autonomous decision making, potentially leading to tough negotiations similar to those witnessed between the EU and US to date, itself a relationship that will be impacted by any changes in the EU's approach to third countries.

BlackRock is prepared for any scenario, including a no-deal scenario, to ensure we can continue to service our clients in both the UK and the EU regardless of political fluctuations.

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