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Sustainable Architecture for Finance in Europe (https://safe-frankfurt.de/)

SAFE Finance Blog

The SAFE Regulatory Radar in September

09/30/2019

Strengthening liquidity stress tests for European investment funds, crypto-assets regulation in the EU, the launch of German property tax reform in 2020 and revising the EU fiscal rules: a selection of financial regulatory developments from this month

At the end of each month, the SAFE Regulatory Radar highlights a selection of important news and developments on financial regulation at national and EU level.

Capital Markets Union: New guidance to strengthen liquidity stress tests for investment funds

On 2 September 2019, the European Securities and Markets Authority (ESMA) published guidance (https://www.esma.europa.eu/sites/default/files/library/esma34-39-882_final_report_guidelines_on_lst_in_ucits_and_aifs.pdf)regarding liquidity stress tests of investment funds. The guidelines contain the recommendations on how market participants carry out stress testing requirements set out in the Alternative Investment Fund Managers Directive 2011/61/EU (https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32011L0061) (AIFMD) and UCITS Directive 2009/65/EC (https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32009L0065). The document aims to establish consistent, efficient and effective supervisory practices on European financial markets.

ESMA's guidelines apply to investment fund managers and depositaries. Managers of AIFs and UCITS (Undertakings for Collective Investments in Transferable Securities) are required to use stress testing as a tool to mitigate liquidity risk. They have to follow a set of recommendations when designing the scenarios, policies, and frequency of liquidity stress tests for the funds. For instance, in setting up stress test models, managers have to determine risks that may impact the fund's liquidity and types of scenarios to use and their severity. ESMA also suggests managers notifying national authorities of material risks and actions taken to address them. According to the guidance, a depositary should provide appropriate procedures to verify that the fund manager has in place documented procedures for its liquidity stress testing program.

These non-binding requirements aim to foster convergent supervision of liquidity stress testing across the EU. The member states have to inform ESMA whether they comply or intend to comply with the guidelines within two months. The guidelines will apply from 30 September 2020.

Crypto-assets: European Commission is working on regulation

On 28 August 2019, Vice-President Valdis Dombrovskis (https://ec.europa.eu/commission/commissioners/2014-2019/dombrovskis_en) published an answer (https://www.europarl.europa.eu/doceo/document/E-9-2019-002268-ASW_EN.pdf)on behalf of the European Commission concerning crypto-assets. In January 2019, the European Securities and Markets Authority (ESMA (https://www.esma.europa.eu/press-news/esma-news/crypto-assets-need-common-eu-wide-approach-ensure-investor-protection)) and the European Banking Authority (EBA (https://eba.europa.eu/-/eba-reports-on-crypto-assets)) recommended the Commission to take a closer look at the challenges and opportunities arising from crypto-assets, particularly digital currencies. Dombrovskis has noted that the Commission is working in two streams. According to him, firstly, it wants to ensure that European legislation does not hinder innovations in this sphere. Secondly, the Commission is engaged to assess the merits of a possible European regulatory approach, notably to provide consumer protection. Both assessments are expected to be published by April 2020.

Regarding Facebook's planned cryptocurrency Libra, the Commission states that it is currently monitoring this project and assessing possible risks to financial stability, data privacy, consumer protection, monetary policy, competition, money laundering, and cybersecurity. In cooperation with ESMA and EBA, the Commission is working on a preliminary assessment of the legal nature of Libra. The Commission also cooperates with international bodies, such as the Financial Stability Board (FSB), the Financial Action Task Force (FATF) and the International Organization of Securities Commissions (IOSCO) to manage any risks that Libra may cause.

The European Commission is not the only one thinking about crypo-assets, however. On 18 September, the German Federal Government passed a Blockchain strategy (https://www.bundesregierung.de/breg-en/news/blockchain-strategie-1673014) to foster investments in the technology and defined important measures in five fields of action. These are the financial sector, innovation, investments, administrative services, and disseminating information. As a next step, the German Government will organize a series of dialogues with representatives from business, politics, and science.

New property tax law in Germany goes into effect in 2020

The German Federal Government assumes (https://www.bundestag.de/presse/hib/657150-657150)that property tax reform act will be adopted at the latest by 31 December 2019 and will enter into force on 1 January 2020. As stated in the decision (https://www.bundesverfassungsgericht.de/SharedDocs/Pressemitteilungen/DE/2018/bvg18-021.html)of the Federal Constitutional Court, the existing rules can continue to be applied only until the end of the year. With the tax reform, the legislator aims to make the property tax fair and compatible with the constitution.

On 11 September 2019, two public hearings were held in the Finance Committee. On the first public hearing, the members of the committee and experts discussed the bill (19/11084 (http://dip21.bundestag.de/dip21/btd/19/110/1911084.pdf)) introducing the flexibility clause for the federal states. According to the proposed draft, Articles 72 (https://www.bundestag.de/parlament/aufgaben/rechtsgrundlagen/grundgesetz/gg_07-245138), 105 (https://www.bundestag.de/parlament/aufgaben/rechtsgrundlagen/grundgesetz/gg_10-245148) and 125b (https://www.bundestag.de/parlament/aufgaben/rechtsgrundlagen/grundgesetz/gg_11-245152) of the German Basic Law have to be amended. At the second public hearing, the members discussed the new rules on the valuation of property for real property tax (19/11085 (http://dip21.bundestag.de/dip21/btd/19/110/1911085.pdf)) and a new category of real property tax to mobilize properties that are ready for development (19/11086 (http://dip21.bundestag.de/dip21/btd/19/110/1911086.pdf)). The July edition (https://safe-frankfurt.de/policy-blog/details/the-safe-regulatory-radar-in-july.html) of the SAFE Regulatory Radar outlined the details of the proposal.

The representatives of the cities and municipalities welcomed the draft laws submitted by the CDU/CSU and SPD coalition; academia and industry evaluated it critically (https://www.bundestag.de/presse/hib/657182-657182), however. According to Professor Henning Tappe (https://www.uni-trier.de/index.php?id=54959) (University of Trier), an introduction of a flexibility clause for the federal states would eliminate federal regulation; therefore, federal competence should be constitutionally guaranteed. Professor Lorenz Jarass (http://www.jarass.com/home/de/lebenslauf) (Rhein-Main University of Applied Sciences) explained that the bill would lead to unsystematic and contradictory property taxes. Professor Johanna Hey (http://www.steuerrecht.uni-koeln.de/8760.html?&L=0) (University of Cologne) stated that the new calculation methods would lead to significant undervaluation of real estate in expensive locations, while properties in unattractive locations would be overpriced. The Federal Association of German Housing and Real Estate Companies (Bundesverband deutscher Wohnungs- und Immobilienunternehmen, GdW) requested changes to the proposed assessment procedure. Otherwise, affordable housing would be massively burdened.

European Fiscal Board: EU fiscal rules need to be revised

On 11 September 2019, the European Fiscal Board (EFB (https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/european-fiscal-board-efb_en)), an independent advisory board on fiscal matters set up by the European Commission, published an assessment (https://ec.europa.eu/info/publications/assessment-eu-fiscal-rules-focus-six-and-two-pack-legislation_en) on the EU fiscal rules.

The EFB proposes a radical simplification of the European Union's Stability and Growth Pact (https://ec.europa.eu/info/business-economy-euro/economic-and-fiscal-policy-coordination/eu-economic-governance-monitoring-prevention-correction/stability-and-growth-pact/legal-basis-stability-and-growth-pact_en) to ensure the long-term sustainability of public finances. Originally adopted in 1997 and revised in 2005, 2011, and 2013, according to the EFB, the European fiscal rules have become too complex.

The EFB's idea is to base the Stability and Growth Pact on one single target (sustainable public debt), one single instrument (controlling net expenditure growth) and one general escape clause. EFB suggests that member states which have above 60 percent debt must keep the growth rate of net government primary spending (expenditure fewer interest payments on public debt) at or below the rate of the economy's potential GDP growth.

During the informal meeting (https://eu2019.fi/en/events/2019-09-13/informal-meeting-of-ministers-for-economic-and-financial-affairs-ecofin-and-eurogroup) on 14 September 2019 in Helsinki, the economic and financial affairs ministers of EU member states supported the idea of the EFB to focus fiscal rules on debt and spending instead of on the structural deficit.

Valdis Dombrovskis (https://ec.europa.eu/commission/commissioners/2014-2019/dombrovskis_en), Vice President of the European Commission noted (https://af.reuters.com/article/bondsNews/idUSL5N26504F) that the reform of EU rules should proceed cautiously; according to him, the reform does not mean revising the key fiscal targets but rather only what parameters to use.

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