

BETTER FINANCE Position on the Intra-EU Investment Protection Facilitation Initiative

Ref: European Commission initiative to strengthen and improve the intra-EU investment protection framework

EXECUTIVE SUMMARY

Single rulebook for investment protection

BETTER FINANCE believes that a Single Rulebook for cross-border investments would significantly improve the issue of information availability for individual, non-professional investors. What individual investors need is clarity on the applicable rules, as well as predictability and stability of the regulatory framework (including changes in laws and regulations which impact your investment). In addition, there are insufficient safeguards in procedural rules of the EU Member States and a lack of availability of interim measures in establishing state liability.

Uneven investor protection

A key factor hurting cross border investment by EU citizens are the administrative barriers (often illegal), especially in the taxation area. Decisions to invest cross-border are also hampered by a lack of research availability. A centralized information mechanism which includes easily accessible, reliable, understandable and comparable public information both for companies and individual investors would therefore be very helpful to mobilize cross-border investments.

Enforcement

The Wirecard case is an example that raises severe concerns about the effectiveness of national/EU supervisory mechanisms. BETTER FINANCE believes that creating an Ombudsman-like EU administrative body, or even a specialised EU investment court, where investors could bring cross-border investor-to-State complaints, would prove to be very effective and beneficial to individual investors.

Supervision

The current system of financial supervision comprises flaws and requires stronger, international cooperation between local supervisors and EU authorities. Moreover, systems to assess the effectiveness of supervision, as well as improvements on penalties and communications concerning shareholder damage are also needed.

Background

Cross-border investments within the EU are at the core of the single market and embody two of the four fundamental freedoms: the free movement of capital and the freedom to establish and provide services. However, the current level of cross-border investments is quite low in spite of having a protected, borderless internal market without borders. In an attempt to improve the cross-border investments' environment, the European Commission (EC) published in 2018 a communication¹ explaining the applicable rules for investment protection and facilitation and also giving examples of case law (Court of Justice of the EU, "CJEU"). However, input received by the EC from stakeholders pointed out continued reluctance of investors to reach or extend investments outside their domicile jurisdiction. The EC noted stakeholders' concerns that the cross-border investment "climate has been deteriorating over the last years, notably because of sudden and unforeseeable changes in the regulatory framework or due to a loss of trust in the effective enforcement of their rights".²

With the termination of the intra-EU bilateral investment treaties (BITs) in 2020 – which received significant criticism for overlapping with the EU single market rules – the EC launched an initiative to improve the investor protection and facilitation framework at EU level. This initiative was reiterated in the new Capital Markets Union (CMU) Action Plan (AP): "The Commission will propose to strengthen the investment protection and facilitation framework in the EU",³ identifying the need to improve dispute resolution mechanisms, to ensure consistent protection vis-à-vis State measures and gather information on investor rights.

Cross-border investments are particularly important for EU citizens as individual, non-professional investors. In order to develop local capital markets and integrate them into the CMU, in order to enable to citizens optimise their returns and enable businesses across the EU to benefit of stable, long-term funding, the intra-EU investor protection and facilitation regime must be modernised and improved.

Moreover, as highlighted by the EC, the global health pandemic may further reduce the level of cross-border investments, which would create even higher funding gaps and hamper recovery for European businesses.

This side of the topic of cross-border investments refers to **direct** investments by EU individual investors, as for **indirect** investments (packaged products) there are other harmonised regimes allowing investment products to be sold (passported) across the EU. Those regimes, including the rules on distribution, marketing provisions and regulatory reporting (*pre-contractual disclosure*), are intrinsic to a well-functioning and attractive CMU and must be developed in parallel.

¹ Communication from the European Commission to the European Parliament and the Council on Protection of intra-EU investment, COM/2018/547 final, available at <https://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A52018DC0547>.

² European Commission Public Consultation Document on An Intra-EU Investment Protection and Facilitation Initiative, available at : https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2020-investment-protection-consultation-document_en.pdf.

³ Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: "A Capital Markets Union for People and Businesses - New Action Plan", COM/2020/590 final, ("New CMU AP"), Action 15, available at: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2020:590:FIN>.

BETTER FINANCE Position

This document comprises the position of BETTER FINANCE on the European Commission's initiative for an intra-EU investment protection and facilitation regime. The responses follow the questions from the EC's public consultation on the same topic and of the EU Investor Survey supporting the study on investment protection and facilitation in the EU. The position follows the two issues identified in the survey, i.e. (i) *the uneven level of investment protection in different Member States that affects investor confidence* and the (ii) *concerns about enforcement of rights and effective remedies for cross-border investors*. In addition, the position expresses BETTER FINANCE's position towards (iii) *information availability* and (iv) *financial supervision*.

GENERAL COMMENT

As indicated in the 2016 Special Eurobarometer on Financial Products (446⁴), most respondents invest (purchase products or services) at domestic level only: 33% of respondents acquire all necessary in their own Member State, 21% prefer to acquire financial products and services locally and 14% prefer to buy them face-to-face.

BETTER FINANCE members consider that the current regulatory framework for cross-border investments is not elaborated or tailored to incentivise, nor to be considered neutral towards intra-EU investments. Thus, the initiative of the European Commission is welcomed by BETTER FINANCE as an essential step towards building a true internal market for capital and financial services. The reasons for which the current framework is deemed flawed are elaborated below.

I. Single rulebook for cross-border investments

As highlighted by the EC, the *EU acquis* on cross-border investment protection is scattered across many legal instruments with different powers (Directives, Regulations, Delegated Acts), on top of which the case law of the CJEU must be added, not considering the national transposition laws (for Directives) and the complementary provisions (Member State competence) in each field in question. In practice, the regulatory framework is extremely complex, making it very difficult to identify the laws applicable to a particular situation. It is clear from the EC's 2018 Communication how complex the EU framework for intra-EU investment protection is. This results legal ambiguity, reduces trust and can give individual investors the sense of not being protected.

BETTER FINANCE members expressed concerns about the *costs and burden of finding information on the legal framework regulating investments*, which can be very difficult at a cross-border level. However, BETTER FINANCE members are aware that certain rights and principles can be relied upon when investing cross-border, such as the *right to compensation* in case of expropriation, the *principle of legal certainty and legitimate expectations* and the *right to good administration*. In terms of clarity of the content, BETTER FINANCE members identified the *principle of legal certainty and legitimate expectations*. In terms of obtaining the information on the rules, procedures and data relevant for cross-border investments in the EU, BETTER FINANCE members believe that information is scattered and difficult to obtain (not readily available or easily accessible online).

BETTER FINANCE advocates not for more, but better regulation. A simplification and codification of the existing rules, under the form of *single rulebooks*, would be preferable. However, should such an endeavour prove too lengthy or complex, the European Commission should take a step further the 2018 Communication and create a tool that would at least provide clarity for individual investors and businesses and coordinate with competent authorities and national actors (such as civil society organisations) to disseminate it.

⁴ https://data.europa.eu/euodp/en/data/dataset/S2108_85_1_446_ENG.

As highlighted in academic literature:

*“Respondents who trust the European Union are more likely to invest in capital markets and diversify their savings”.*⁵

In terms of information availability, BETTER FINANCE considers the following factors to be of significant importance in the decision of individual investors to invest cross-border:

- *Ease of finding information on investment protection rules under the EU legal framework;*
- *Clarity on the applicable rules protecting investment under the EU legal framework;*
- *Predictability and stability of the regulatory framework (including changes in laws and regulations which impact your investment);*
- *Insufficient safeguards in procedural rules of the EU Member State(s), such as lack of legal standing to challenge laws which are contrary to EU law, remedies not in the same procedure, or*
- *lack of availability of interim measures difficulty in establishing state liability for breaches of EU law.*

In addition, a BETTER FINANCE member organisation indicated that, among other initiatives combined, a good measure to improve the understanding of the mechanics of the market would be to improve the basic financial education (in high school). This would go hand-in-hand with a Government-based campaign to promote investing in shares and bonds. Currently, there is a “counter culture” against investments in the stock markets which is illustrated by the high amounts held in illiquid and unproductive savings accounts.

Lastly, a special EU body or institution could be set up to provide continuous clear and basic information on products, events, legislation and case law; this would act as a contact point or information hub (similar to the financial innovators facilitation hub), which would significantly improve the uncertainty for smaller investors.

II. Uneven level of investment protection

A key factor hurting any development of cross border investment by EU citizens within the EU are the administrative barriers to cross-border investments and their discrimination – often illegal - within the single market, especially in the taxation area. We can provide specific evidence, in particular on investment income and on inheritance taxes: *de facto* double taxation, administrative illegal harassment, and tax discrimination are widespread within the EU: that is a major deterrent to invest cross-border.

Decisions to invest cross-border are not only hampered by national barriers or hurdles, or by a lack of investment protection or enforcement factors. It is also a lack of research availability that hinders individual investors to invest cross-border as they simply are not aware of investment opportunities abroad. A centralized information mechanism which includes easily accessible, reliable, understandable and comparable public information both for companies and individual investors, e.g. investment research, educational tools etc. would therefore be very helpful to mobilize cross-border investments. Also, we think there is a need to strengthen corporate governance rules, among others by introducing a common definition of “shareholder” to strengthen engagement with investee companies also in case of cross-border investments. We are pointing to:

1. Double taxation of investment income - dividends⁶ in particular, of inheritance of real estate investments in another member state, illegal harassment by Member State tax administration
2. The inefficient and cumbersome withholding tax procedures on interests and dividend payments which lead numerous of our members to divest in those Member States which build up (procedural) hurdles for individual investors to reclaim their double taxed dividend/interest income.

⁵ Elisabeth Beckmann, Davide Salvatore Mare, ‘Formal and Informal Household Savings: How Does Trust in Financial Institutions Influence the Choice of Saving Instruments?’ (1 August 2017), p. 12.

⁶ For instance, in Belgium tax on dividends is withheld in the country of origin and in Belgium (30% on the remaining amount); this leads to a big chunk of the dividend yield being taken of the portfolio, which can be very difficult to claw back; if dividends come from a country with which Belgium has concluded a double-tax treaty, the tax on dividends can be reclaimed after the necessary paperwork is done, whose practical handling sows confusion; moreover, while domestic banks can withhold directly the tax on dividends from the account, if the dividends come from another country, these have to be stated on the tax return.

3. The different treatment of delisting rules in various Member States is a problem - individual investors should have a common/harmonised level of safeguards when having invested in companies that plan to exit capital market financing.

BETTER FINANCE members expressed concerns about the *uncertainties regarding the setting-up or exercising activities linked to cross-border investments*, as well as on the different treatments of investments, depending on whether these have a domestic or cross-border nature. We understand that Member States still retain a right to regulate in order to protect public interest, but it would be useful to clarify at EU level how should public interests be balanced against the minimum level of protection individuals need in order to plan and undertake cross-border investments. In what concerns taxation, the principle of fiscal certainty and proper administration (amongst others by banks) are judged of major importance for local investors deciding to invest abroad.

Furthermore, in order to enhance transparency and mitigate the negative impact on investors of Member States policies, BETTER FINANCE members pointed out to the need to better involve stakeholders concerned in the discussions underlying the policy measures, as well as informing them of the projected policy measures in advance.

Moreover, the decision to invest cross-border (in other EU Member States) is affected – most importantly - by the administrative conduct of Member States (i.e. treatment towards foreign investors, efficiency in obtaining necessary government permits and approvals to start or expand operating a business, reasoning of administrative decisions). At the same time, obtaining appropriate compensation for restriction of property and economic rights and the functioning of the enforcement system in the host Member State as regards investor rights are also deterrents to invest cross-border. Lastly, the insufficient safeguards related to good administrative conduct (e.g. non-discriminatory treatment of foreign investors, adoption of administrative decisions within reasonable time) also can deter individual investors from investing cross-border. In terms of the possible solutions⁷ to address these issues, BETTER FINANCE believes that a positive impact could be brought by:

- *Increasing the visibility and transparency of existing EU and national rules without changing the content of those rules;*
- *Targeted specification and improvement of some rules on investment protection related to cross-border investments; or*
- *Specifying and improving the investment protection rules in a more comprehensive way (e.g. by also clarifying types of justified and unjustified restrictions).*

III. Enforcement

The Wirecard case is an example that raises severe concerns about the effectiveness of national/EU supervisory mechanisms and their endowment with sufficient powers and governance structures to oversee large companies with complex business models acting worldwide. BETTER FINANCE members believe that enforcement at local level, through domestic courts and authorities, would only partially address enforcement issues. As such, BETTER FINANCE recommends improving enforcement mechanisms at EU level and establishing EU bodies or authorities to deal with such issues, such as an *EU ombudsman-like body* or an *EU investment court responsible for solving individual cross-border investment disputes*.

In this sense, BETTER FINANCE believes that several policy options⁸ outlines would bring a positive impact:

- *Enhancing mechanisms preventing problems or resolving investor-to-state disputes amicably;*
- *Improving enforcement of rights before national courts by streamlining selected procedural rules in relation to specific matters for which an internal market issue has been detected;*
- *creating an Ombudsman-like EU administrative body where investors could bring cross-border investor-to-State complaints;*

⁷ Options proposed by the European Commission.

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- *creating a specialised investment court at EU level.*

BETTER FINANCE members believe that the case law of the CJEU is insufficiently known by smaller investors and it would be better to set up local courts for investment disputes, as this could aid to alleviate the problem. A new judicial body set up at EU level could be the appeal court for these “local” investment courts.

In addition to the policy options proposed by the European Commission, BETTER FINANCE believes there is a necessity to introduce an EU-wide collective redress mechanism also for individual investors wanting to invest cross-border in listed securities (which is currently not the case, and not in the recent EC CMU Action Plan despite being clear priority recommendation from the HLF CMU to stop discriminating individual non-professional equity and bond investors in the draft EU Directive on collective redress, and despite the “Wirecard scandal” that happened in between).

IV. Financial supervision

BETTER FINANCE members believe that the EU should focus on several factors to improve financial supervision affecting cross-border investments:

- elaboration of more detailed international supervisory standards;
- stronger international cooperation within the European System of Financial Supervisors and stronger actions, not merely “warnings” – in this sense, see the BETTER FINANCE Key Priorities for 2019 – 2024 on strengthening the powers and tools of the European Supervisory Authorities;
- the need to develop and implement a mechanism to measure the effectiveness of international supervision;
- particularly for shareholder rights, to improve the system of penalties and communication of decisions on issuers concerning shareholder damage;
- soft law measures, such as better public communication with financial supervisors and companies, without initiating public law procedures or rules, would also be beneficial.