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COMMISSION STAFF WORKING DOCUMENT

ON THE MOVEMENT OF CAPITAL AND THE FREEDOM OF PAYMENTS

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1 INTRODUCTION

The free movement of capital is essential in enabling integrated, open and efficient European financial markets for the benefit of European businesses and citizens. It is a key element of the European single market and enshrined as one of the four fundamental freedoms in the EU Treaties. This document reports on capital movements and policy initiatives relating to the free movement of capital in 2017-2018. It will feed into discussions held annually by the Economic and Financial Committee to examine capital movements and the freedom of payments under Article 134 of the Treaty on the Functioning of the European Union.

This report firstly reviews global and EU capital flows in 2017 and the first half of 2018 (depending on data availability) as well as related economic developments. In the second part, it sets out the legal framework, details recent policy initiatives and important challenges, and reviews global developments in relation to the free movement of capital and the freedom of payments.

Both global and EU cross-border investment slowed down in 2017 and the first half of 2018. This was against a background of trade tensions, policy uncertainty, rising energy prices and moderating growth momentum. Nevertheless, the EU remained the world's most important source and destination of investment. Furthermore, the number of intra-EU mergers and acquisitions continued to increase.

Global and EU capital flows moderated compared to the previous decade, although they remain much higher now than in the immediate aftermath of the financial crisis. In the medium term, net capital flows are expected to continue to decline, after a slight increase in 2018. This is mostly on the back of smaller surpluses recorded by oil exporting countries and China. Gradual increases in US rates are tightening financial conditions globally and have contributed to bouts of volatility, with sharp depreciations in emerging market currencies.

From a forward-looking perspective, downside risks seem to be higher than the upside risks and the range of possible outcomes is widening. The near-term global growth outlook is clouded by persistent and elevated uncertainties. Trade tensions show few signs of abating and tariffs have the potential to disrupt corporate supply chains and dent business confidence.

Sustaining free movement of capital is particularly important at the current juncture against this backdrop of increased policy and geopolitical uncertainty globally, slowing cross-border investment and the need to sustain the economic recovery. The Commission is committed to addressing barriers impeding the free movement of capital within the EU. Implementing the Capital Markets Union is key to attaining this objective; the Commission has delivered most of the measures announced in the 2015 Capital Markets Union Action Plan and in the 2017 mid-term review of the Capital Markets Union Action Plan. These include, for example, proposals to create an EU framework for covered bonds, foster the cross-border distribution of funds and facilitate cross-border payments.

Building the Capital Markets Union is also a national task. In this regard, the Commission worked together with the Member States to encourage and support them in removing their barriers on a voluntary and cooperative basis. One result of this collaborative approach is the adoption by the Member States of a code of conduct that aims at improving the efficiency of current withholding tax procedures. Beyond this approach, strategic use of enforcement and, more specifically, infringements remain an important tool enabling the Commission to tackle barriers to the free movement of capital.

To foster cross-border investment it is important that investors feel their rights are protected. Investment protection is an important factor in the decision to invest abroad. In July 2018, the Commission adopted the Communication on protection of intra-EU investment in order to strengthen the business environment for EU investors. It explains EU investor rights in a single document, these rights being set out across different legal instruments and contained in case-law. The Communication helps investors identify their rights under EU law and enforce these rights before national administrations and courts.

While free movement of capital is crucial in building efficient financial markets, it also brings challenges that cannot be ignored. For example, foreign investors might seek to acquire strategic assets in a way that poses risks to security or public order. The Commission therefore proposed a new legal framework[1] for screening foreign direct investment from non-EU countries. A political agreement was reached on this in November 2018. Another challenge, highlighted by recent cases, is preventing money laundering and the financing of terrorism. To this end, the Commission made a proposal to further strengthen the supervision of EU financial institutions in this area[2].

2 TRENDS IN EU CAPITAL FLOWS IN THE GLOBAL CONTEXT, 2017-2018

2.1 Global and EU capital flows[3]

The current account balance, the discrepancy between the aggregate gross savings of a country's residents and the level of domestic investment spending equate to the net accumulation of foreign assets or 'borrowing' from the rest of the world. Together they serve as a tractable indicator of the cross-border direction of capital since 2009.

Global current account imbalances moderated compared to the pre-crisis period, which is deemed to have been characterised by large 'global imbalances'. However, they appear to be much higher now than in the immediate aftermath of the financial crisis in 2009. There was also a shift of imbalances towards advanced economies. These trends

[1] http://trade.ec.europa.eu/doclib/press/index.cfm?id=1716

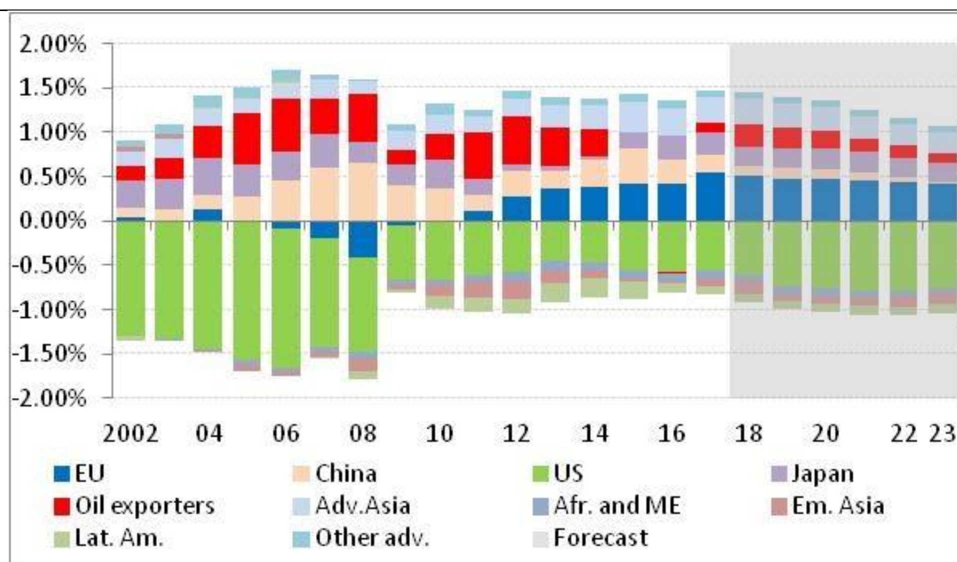
[2] http://europa.eu/rapid/press-release_IP-18-5724_en.htm

[3] This section includes work done by Bruegel as part of the study 'Analysis of EU capital flows in the global context', prepared for the European Commission.

continued in 2017, save for a slight moderation in the overall levels of imbalances (see Chart 1). In the medium term global current account balances are expected to narrow marginally, after widening slightly in 2018. This is mostly on the back of smaller surpluses recorded by oil exporting countries and China.

The EU's current account balance is expected to remain positive over the medium term. This follows a switch from balanced or slightly positive to significantly positive, as the block experienced a 'double-dip' recession and implemented a policy mix of simultaneous fiscal consolidation and monetary expansion. In absolute terms, the EU is now the largest exporter of capital in the world. It joined Japan and China to form a group of systemic economies that persistently generate current account surpluses resulting in the largest share of savings invested abroad.

Chart 1 — Global current account balance, % of world GDP



Source: DG FISMA based on IMF WEO October 2018.

Notes: Adv. Asia = advanced Asia (Hong Kong SAR, South Korea, Singapore, Taiwan Province of China); Afr. and ME = Africa and the Middle East (Democratic Republic of the Congo, Egypt, Ethiopia, Ghana, Jordan, Kenya, Lebanon, Morocco, South Africa, Sudan, Tanzania, Tunisia); Em. Asia = emerging Asia (India, Indonesia, Pakistan, Philippines, Thailand, Turkey, Vietnam); Lat. Am. = Latin America (Argentina, Brazil, Chile, Colombia, Mexico, Peru, Uruguay); Oil exporters = Algeria, Azerbaijan, Iraq, Kazakhstan, Kuwait, Nigeria, Oman, Qatar, Russia, Saudi Arabia, United Arab Emirates, Venezuela; Other adv. = other advanced economies (Australia, Canada, Iceland, Israel, New Zealand, Switzerland).

Emerging markets capital flows

Since the beginning of 2018 capital flows to emerging markets have weakened significantly. Net investment flows into both bonds and equities of those countries has also declined sharply. More specifically, evidence from investment fund flows and other high-frequency data sources suggests that non-resident portfolio flows, which were strong in 2017, turned negative in May 2018. This was consistent with foreign exchange market pressures on several emerging market economies. Outflows resumed and

intensified in August 2018 amid weakening investor sentiment following the depreciation of the Turkish lira and the Argentine peso.

Capital outflows from emerging markets were accompanied by a sell-off of currencies, similar to the 2013 episode known as the 'taper tantrum'. The currency depreciations of 2018 were synchronised across emerging markets. However, the magnitude of the depreciations was much larger across the board. This was despite current account balances not deteriorating across the emerging market spectrum and fundamentals not being worse than in 2013. Most affected were emerging markets with large current account deficits, financed by 'hot money' and with inadequate foreign exchange reserves.

EU capital flows

Since the crisis the EU as a whole and some of its Member States have experienced a current account reversal and its counterpart, the financial account balance[4], has turned positive (see Chart 2). The overall level of extra-EU-28 net and gross flows in 2017 and at the beginning of 2018 was comparable to the previous years. However, there were notable changes in the composition of EU capital flows. Since 2013, capital had been flowing into and out of the EU-28 mainly in the form of foreign direct investment (FDI) and portfolio investment. In the course of 2017 and the first two quarters of 2018, FDI flows, both on the asset and on the liability side, fell and were virtually zero or negative in some quarters. During the same period, increased acquisitions of so-called "*other investment*"[5] assets and incurrence of portfolio equity liabilities offset this reduction in gross FDI flows.

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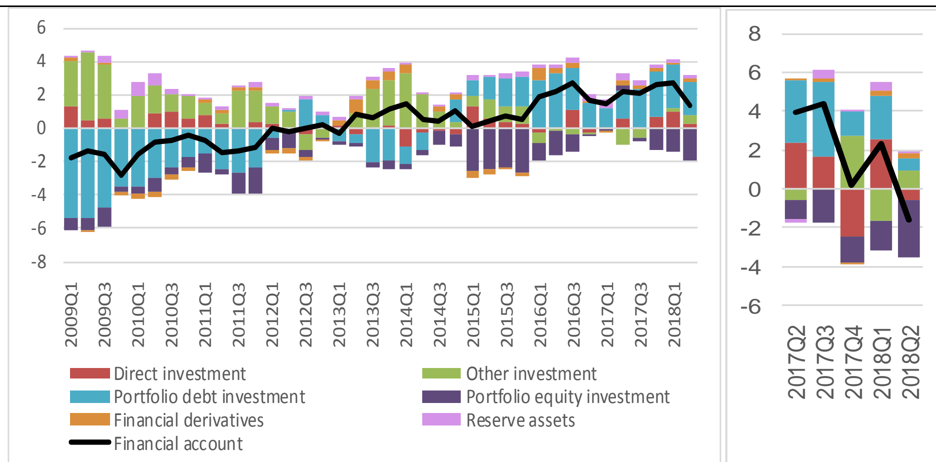
[4] The current account records current transactions, such as exports and imports of goods and services. The financial account records financial transactions, such as sales of stocks and bonds to foreigners. A deficit on one account is accompanied by a surplus on the other so that the financial and current accounts are opposite.

[5] "*Other Investment*" is a residual item in the Balance of Payments comprising all types of investments which cannot be classified as FDI or portfolio investment. In practice it includes mostly loans from banks or official institutions as well as trade credits.

Chart 2 — EU-28 net flows by instrument, % of GDP



Source: Eurostat (bop_eu6_q & namq_10_gdp)

Notes: Left-hand side panel shows a 4Q lagged moving average, whereas the right-hand side panel shows the unsmoothed series over the year preceding the last data point available. The net financial account balance in the Eurostat series includes reserve assets transactions.

2.2 FDI developments

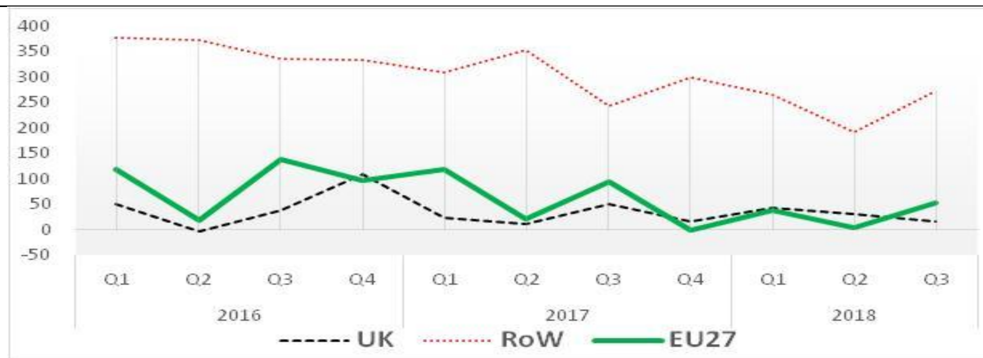
2.2.1 European FDI developments

EU FDI developments

Against the backdrop of a global slowdown in investment, EU28 inward FDI (including both intra-EU as well extra-EU inflows) was lower in 2017 compared to 2016. Latest quarterly data confirm that the investment slowdown is likely to continue in 2018, although a small increase was recorded in the third quarter of the year (see Chart 3). Both the euro area as well as the non-euro area contributed to the slowing down of total inward FDI in 2016-2018 year-to-date with the group of non-euro Member States consisting of Denmark, Sweden and the UK recording the fastest decline[6]. In 2017 the Netherlands overtook the UK as the Member State that received the most inward FDI, while in 2018 (based on the first three quarters) the Member State that received the largest inward FDI flows was Germany.

[6] Member States are grouped for presentation purposes; there may be significant differences in the trends of different countries.

Chart 3 — EU inward FDI, EUR billions



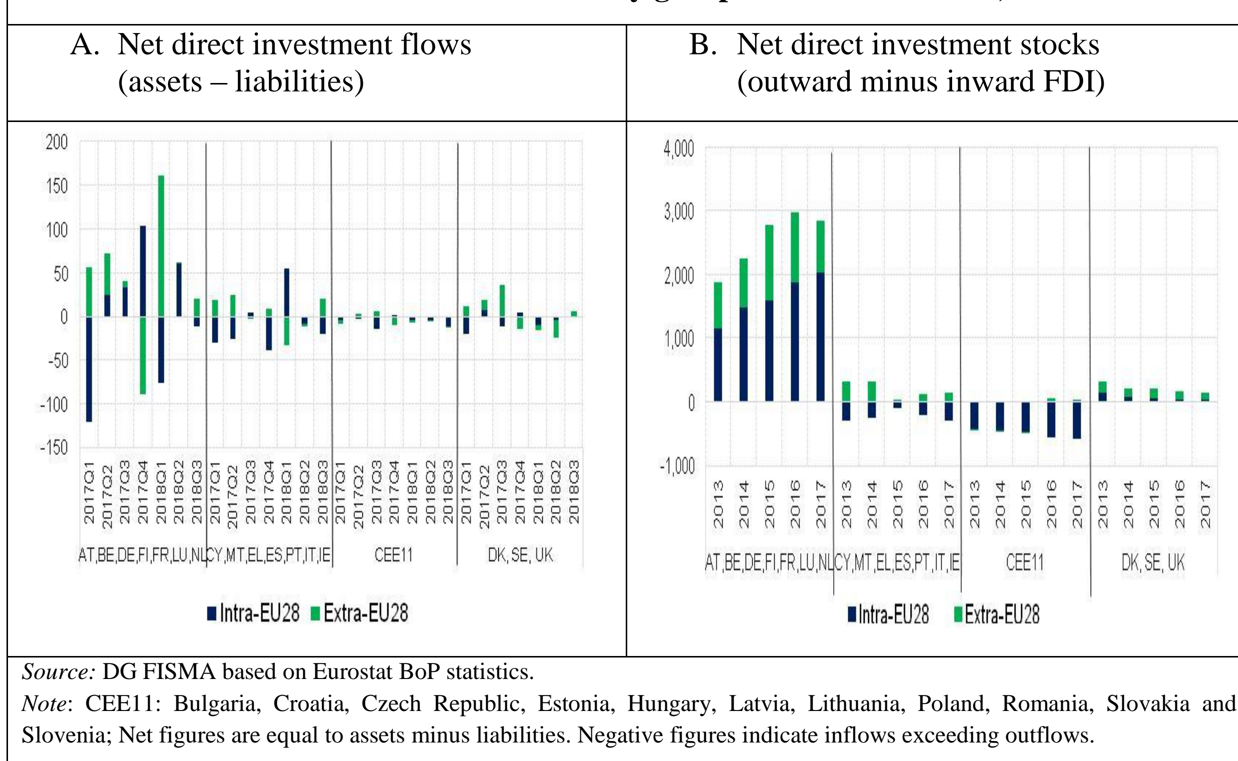
Source : OECD

Notes: EU27 and the UK FDI include both intra and extra-EU bilateral flows.

Net FDI flows by groups of Member States

In terms of flows, the latest figures available for the third quarter of 2018 point to a net slowdown in FDI activity across all geographical areas (see Chart 4, panel A). The most significant year-on-year decline was recorded in the group including Denmark, Sweden and the United Kingdom (-84.3% compared to Q3 2017). It was followed by the first group of euro area countries comprising Austria, Belgium, Finland, France, Germany, Luxembourg and the Netherlands (-75.4%), the second group of euro area countries including Cyprus, Greece, Ireland, Italy, Malta, Portugal and Spain (-66%) and the CEE11 block (-39.3%). In the first group of euro area economies, the year-on-year decline can be attributed largely to the drop in intra-EU flows (down by 68.9% in Q3 2018 from Q3 2017), as it was also the case across the second group of euro area countries and the CEE11 Member States.

Chart 4 — Intra-EU28 vs. extra-EU28 by groups of Member States, billion EUR



Source: DG FISMA based on Eurostat BoP statistics.

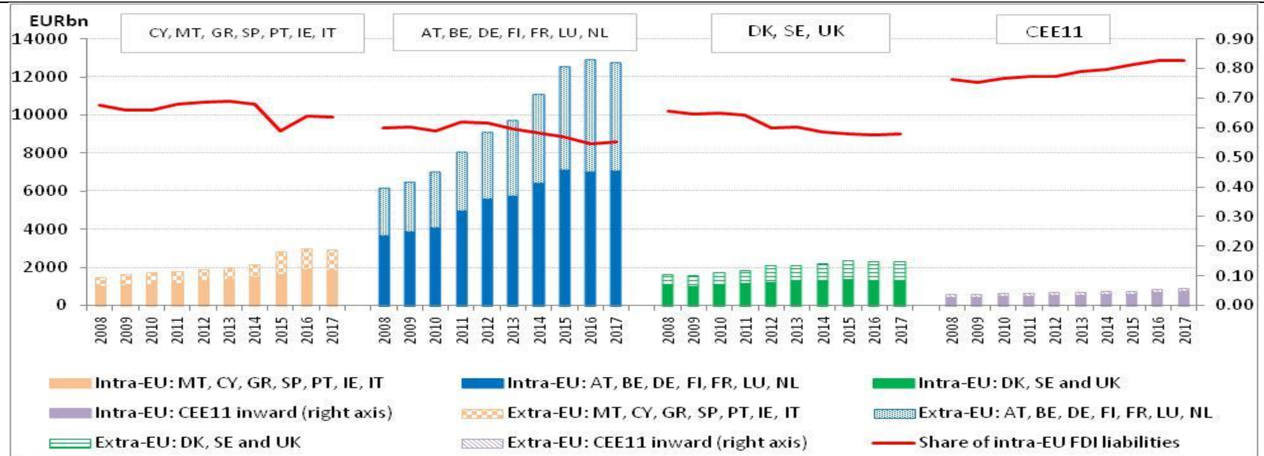
Note: CEE11: Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia; Net figures are equal to assets minus liabilities. Negative figures indicate inflows exceeding outflows.

FDI stocks by groups of Member States

Regarding the net stocks of FDI, the economies in the euro area countries continued to play a major role as both a source and a destination of FDI (see Chart 5). At the end of 2017, the total net amount of FDI stocks reached EUR 2.9 trillion in Austria, Belgium, Finland, France, Germany, Luxembourg and the Netherlands (down by 4.9% compared to 2016). It turned negative (with inward FDI exceeding outward) in the group of euro area countries comprising Cyprus, Malta, Greece, Spain, Portugal, Italy and Ireland (EUR -163.1 billion) and in the CEE11 (EUR -554.7 billion). Intra-EU FDI accounts for the largest share of stocks in all geographical areas, namely 94.6% in the CEE11 block, 72% in the first group of euro area countries and 68.4% in the second group. The only exception is the group comprised of Denmark, Sweden and the United Kingdom, where extra-EU FDI (72.6% of the total net FDI stocks) is more significant than intra-EU FDI.

Similar patterns apply to the gross inward FDI stocks in 2017 with the share of intra-EU FDI rebounding in the first group of euro area countries as well as in Denmark, Sweden and the United Kingdom and stabilizing in the remaining groups of Member States, after declining since 2012 across almost all geographical groupings except CEE11 (see Chart 5).

Chart 5 — Intra and extra-EU FDI stocks of liabilities, by groups of Member States



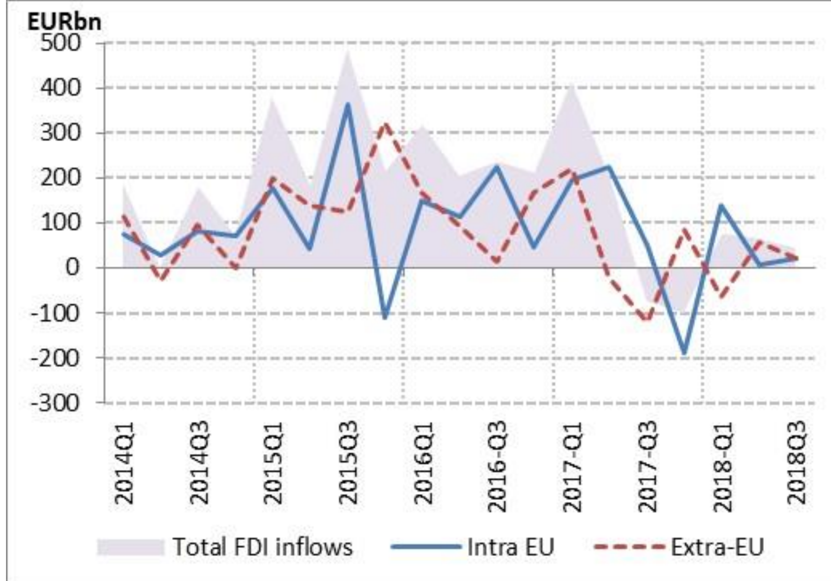
Source: DG FISMA based on Eurostat BoP statistics

Intra-EU versus extra-EU FDI inflows

Intra-EU FDI inflows had a similar dynamic as extra-EU FDI and contributed to the recent decline in total EU FDI inflows from mid-2017 to the second quarter of 2018[7]. The decline in extra-EU FDI preceded that of intra-EU FDI and started at the beginning of 2017. After recovering moderately towards the end of 2017, extra-EU FDI inflows began 2018 in negative territory as non-resident investors were divesting some of their European investments. Intra-EU FDI inflows declined sharply in 2017, reaching deep negative territory in the fourth quarter of 2017. At the beginning of 2018, intra-EU FDI inflows recovered partially but remained at relatively low levels compared to 2015-2016. In the third quarter of 2018 both intra and extra-EU FDI inflows increased, albeit marginally, and were with almost equal magnitude.

[7] The latest available data point as of the cut-off date of the report was the second quarter of 2018.

Chart 6 — Intra and extra-EU FDI inflows



Source: DG FISMA based on EUROSTAT BoP statistics.

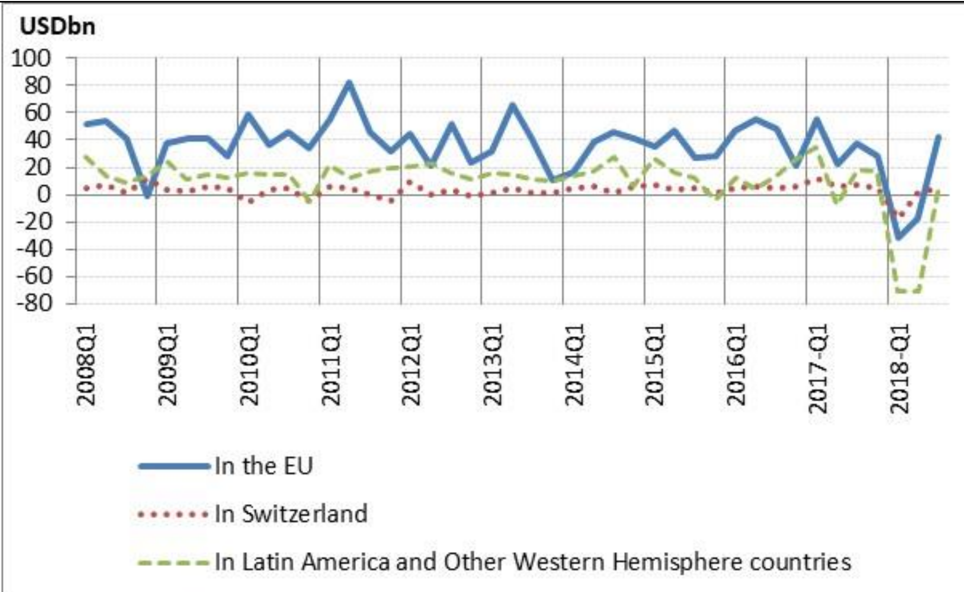
From a geographical point of view, the drop in extra-EU FDI flows seems to have been driven largely by bilateral flows with the USA: flows of FDI assets and liabilities were strongly positive in 2015-16, slowed down in 2017 and began decreasing in 2018.

The bilateral investment relationship between the EU and the USA has traditionally been very important, with US inward FDI accounting for almost 50 % of the total extra-EU FDI inflows in certain years. Data on US FDI in the EU allows us to explore the extent to which the decline in extra-EU FDI inflows could have been due to lower flows of US investment and in turn to try to see what policies or economic factors could have been at play. Indeed, as illustrated in Chart 7, US FDI in the EU declined towards the end of 2017 and the beginning of 2018 as US parent companies withdrew previously made investments in the EU. This could have been triggered by the effects of the 2017 Tax Cuts and Jobs Act (TCJA) on some components of international transactions accounts. Those effects mostly materialised in the form of negative reinvested earnings as dividends and withdrawals were higher than the current earnings for the period[8]. However, in terms of timing, the sharp decline in extra-EU FDI happened as early as mid-2017 and thus before the announcement and entry into force of the TCJA at the beginning of 2018. While the TCJA seems to have affected US FDI abroad in almost all world regions, its effects on US FDI in the EU seem to have been relatively less pronounced than for other regions (see Chart 7). In the third quarter of 2018 US FDI

[8] For more details see 'Effects of the 2017 Tax Cuts and Jobs Act on Components of the International Transactions Accounts', available at: https://www.bea.gov/news/2018/us-international-transactions-second-quarter-2018

abroad and in particular in the EU seems to be returning to its usual (historical average) magnitudes.

Chart 7 — US FDI in the EU and in selected other countries or regions



Source: DG FISMA based on US BEA.

Extra-EU FDI income and rates of return

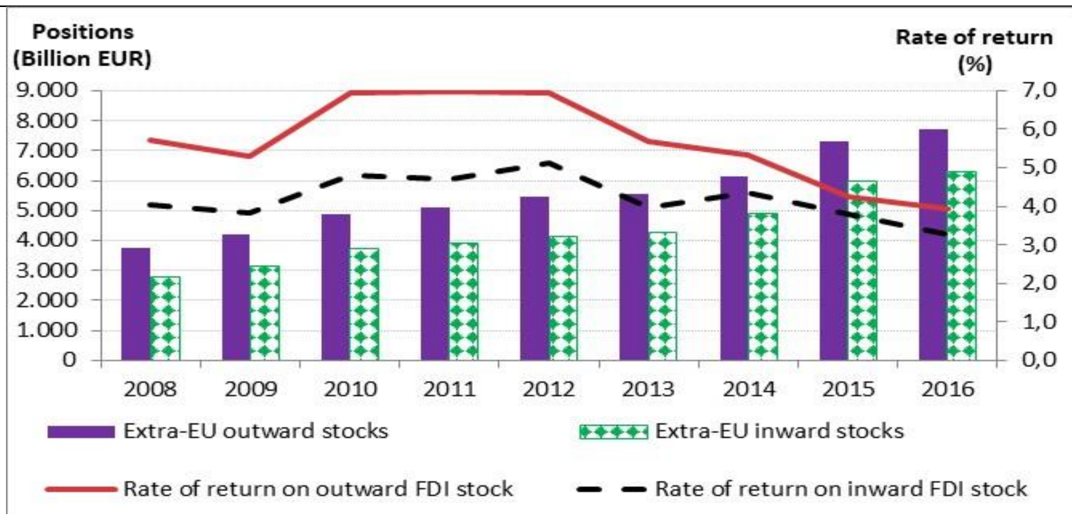
Against the backdrop of a sustained increase in extra-EU FDI positions in the entire post-crisis period, rates of return on FDI were on a downward path in recent years and declined further in 2016 (see Chart 8). The rate of return on both inward and outward extra-EU FDI stocks was lower in 2016 than in 2015, down from 4.2 % to 3.9 % for outward stocks and from 3.8 % to 3.3 % for inward stocks. However, if the entire post-crisis period is taken into account (2008-2016), the rate of return on outward extra-EU FDI declined much faster than that on inward extra-EU FDI and was lower in 2016 compared to 2008 by almost 32% for outward and 20% for inward stocks.

One of the reasons for the declining rates of return was the lower investment income from both outward and inward extra-EU FDI in 2016 compared to 2015. The EU-28's investment income received from non-member countries (on outward FDI) decreased in 2016 to EUR 305 billion, while EU-28 investment income paid to non-member countries (on inward FDI) decreased even more rapidly by more than 10% to EUR 204 billion.

As a consequence, the net income on extra-EU FDI increased from EUR 86 billion in 2015 to EUR 101 billion in 2016. However, the difference between income paid and received (the positive net income balance from extra-EU FDI) was becoming smaller since 2012 due to the decline of income from outward extra-EU FDI (-4.2%) and the rapid increase of income paid to non-member countries (+20%). EU28's net income from FDI made in and received from non-EU countries has been positive (with income

received from non-member countries higher than the income paid to non-member countries) in the entire post-crisis period.

Chart 8 — Extra-EU FDI rates of return and stocks, EU-28, 2008–16 ([1, 2])



Source: Eurostat (online data codes: bop_fdi6_pos and bop_fdi6_inc);
Notes: Structural change in 2013 due to new methodology - based on international standards BPM6 and BD4 as of 2013. All NACE activities only.
([1]) Rate of return: income on investments in year t / stocks at the end of year t-1. ([2]) Extra-EU trade.

2.2.2 *Mergers and acquisitions*[9]

Against the backdrop of a slowing market for international M&As in the rest of the world, EU cross-border corporate restructuring activity is expected to be higher in 2018 than in the previous year (see Chart 9). Both the value and the number of transactions in the EU is expected to be higher than in the previous year. The only weaker spot in 2018 is likely to be the number of extra-EU M&As, which is expected to decline compared to 2017 and fall below that of intra-EU acquisitions for the first time since 2011. However, the number of extra-EU acquisitions of European companies surpassed the pre-crisis peak as early as 2011. Furthermore, the value of extra-EU transactions is expected to increase sharply in 2018, by almost 84 % compared to an increase of around 45 % for the value of intra-EU acquisitions. The sharp increase in the value of announced extra-EU acquisitions is due to some very large transactions in 2018 that also resulted in an increase in the average value of extra-EU acquisitions. The number of intra-EU acquisitions is expected to surpass that of extra-EU acquisitions in 2018. However, both

[9] This section will be updated before publication with data from the end of 2018. Until then, data projections for the fourth quarter of 2018 are based on the average growth rates of the four months that precede it.

the value and the number of intra-EU transactions are still well below their respective pre-crisis peaks.

By groups of Member States, the number of extra-EU transactions was lower in Denmark, Sweden and the UK as well as in the euro area 1[10] countries. In contrast, the number of intra-EU transactions increased in the euro area 14 Member States (euro area 1 and euro area 2[11]) and remained stable in the CEE11[12] and Denmark, Sweden and the UK.

Regarding the value of extra-EU acquisitions, the UK was in first place. This was because some of the mega transactions, including Takeda's bid for Shire, the largest global deal so far in 2018, were UK-targeted. Nevertheless, the number of extra-EU UK-targeted transactions is expected to decrease this year. Next in the ranking of extra-EU transactions by value are expected to be Germany, France and the Netherlands. Regarding intra-EU cross-border corporate restructuring, the Member States with the highest value of transactions in 2018 are expected to be Spain, Germany and the UK.

EU international divestment[13] is expected to increase sharply in 2018 with respect to both intra-EU and extra-EU transactions. Almost 75 % of the divestment transactions are expected to be sales from one foreign company to another foreign company. Only about 25 % are expected to be sales from a foreign company to a domestic enterprise that are thus reducing the stocks of international production capacities and the number of foreign affiliates located in the EU.

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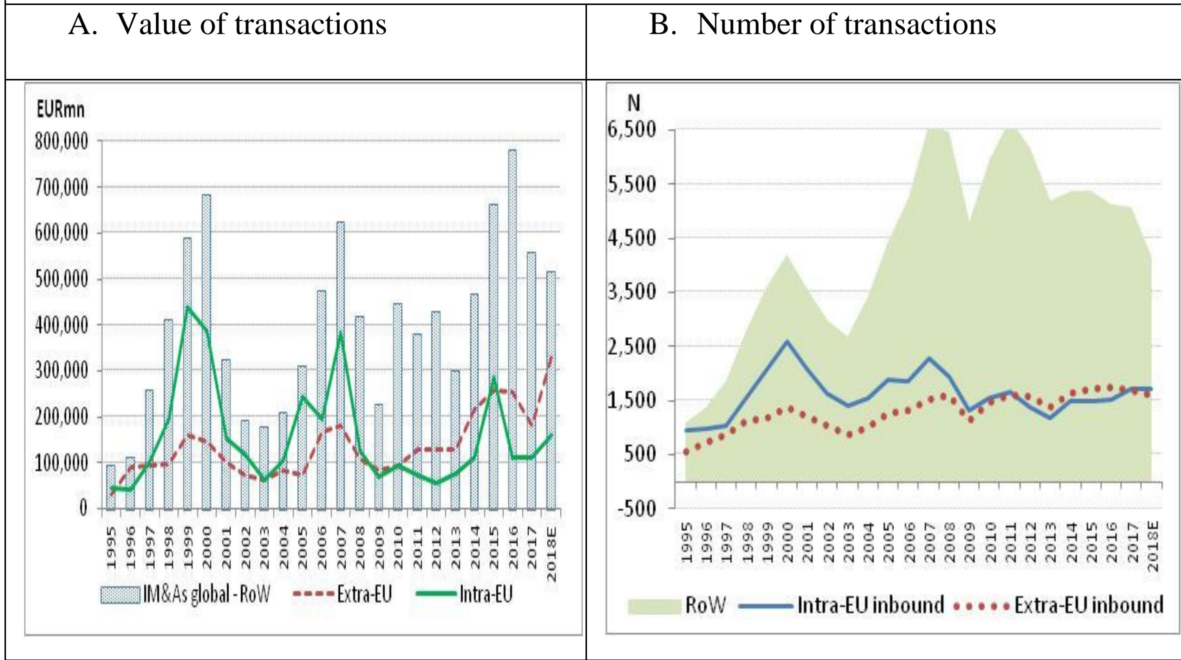
[10] **Euro area 1** countries include: Austria, Belgium, Finland, France, Germany, Luxembourg and the Netherlands.

[11] **Euro area 2** countries include: Cyprus, Greece, Ireland, Italy, Malta, Portugal and Spain.

[12] CEE11 includes the more recently acceded central and eastern European Member States: Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

[13] International divestment includes transactions in which a previously foreign affiliate is sold either to another foreign company or to a domestic company.

Chart 9 — Inward M&A transactions — EU and the rest of the world



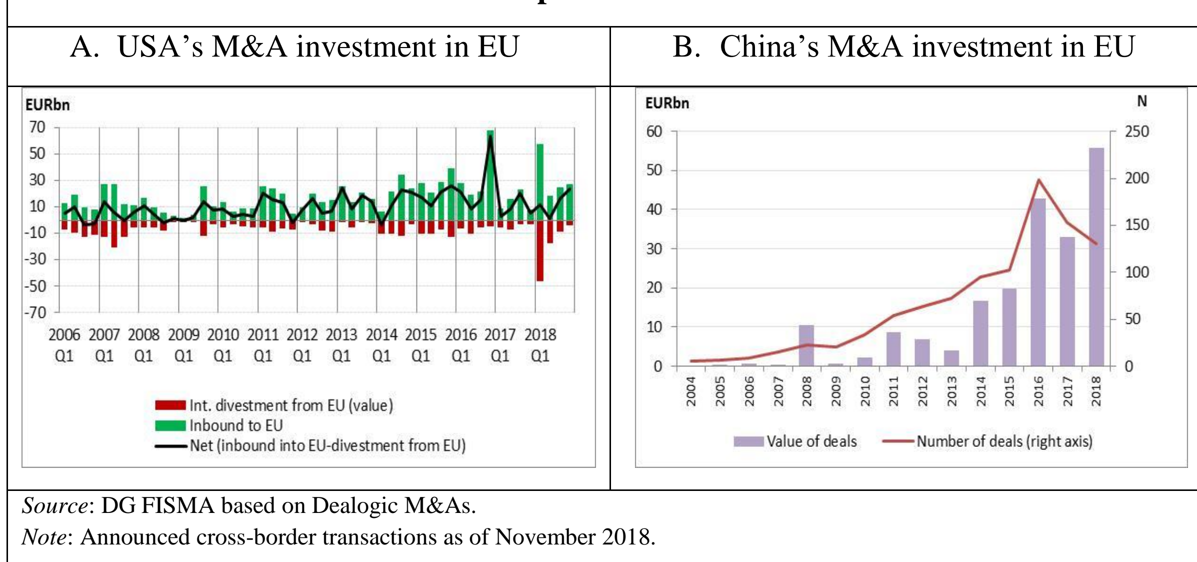
Source: DG FISMA based on Dealogic M&As.
Note: Announced cross-border transactions as of November 2018.

Outward M&As from the USA and China

The USA continues to be the biggest source of extra-EU investment in M&As in the EU. The value of its acquisitions is expected to increase in 2018, after a drop in 2017. This is despite some changes in the legal and tax framework. The tax reform bill Congress passed in December 2017 lowered the US corporate tax rate to 21 %, and could have led US companies to change some of their strategies, including repatriating cash to buy other US assets and selling rather than spinning off some subsidiaries. The increase in US international divestment from the EU spiked in the first quarter of 2018 but seems to have moderated afterwards. Meanwhile, outbound investment from the USA into the EU also spiked in the same quarter, leaving net inflows lower but still positive.

It is expected that the number of Chinese acquisitions in the EU will continue declining in 2018, after the introduction of some restrictions to outbound FDI by the authorities in 2016. However, the value of Chinese acquisitions in the EU is expected to have reached another record high in 2018, after declining in 2017. This reflects the Chinese authorities' investment policy of constraining outbound FDI in certain sectors but maintaining investment in strategic areas.

Chart 10 — Main investment counterparts and sources of M&A investment in the EU



Source: DG FISMA based on Dealogic M&As.
Note: Announced cross-border transactions as of November 2018.

2.3 Portfolio investment developments

EU net portfolio investment flows[14], which traditionally have been negative (with inflows exceeding outflows[15]), turned positive as of 2015. This shift was mostly driven by developments in the euro area and was triggered by both: (i) foreign investors reversing some of their holdings of EU securities (reflected in declining or even negative liabilities), and (ii) increased acquisitions of foreign assets by EU investors (reflected in an increase in foreign assets).

The net increase in euro area holdings of foreign assets in 2015-2018 consisted mostly of debt securities and was due to both long-term and short-term bonds (see Chart 11). In the near term, net EU and euro area portfolio investment could shift back into negative territory with the normalisation of monetary policy conditions and the end of the asset purchase programme announced by the ECB on 13 December[16].

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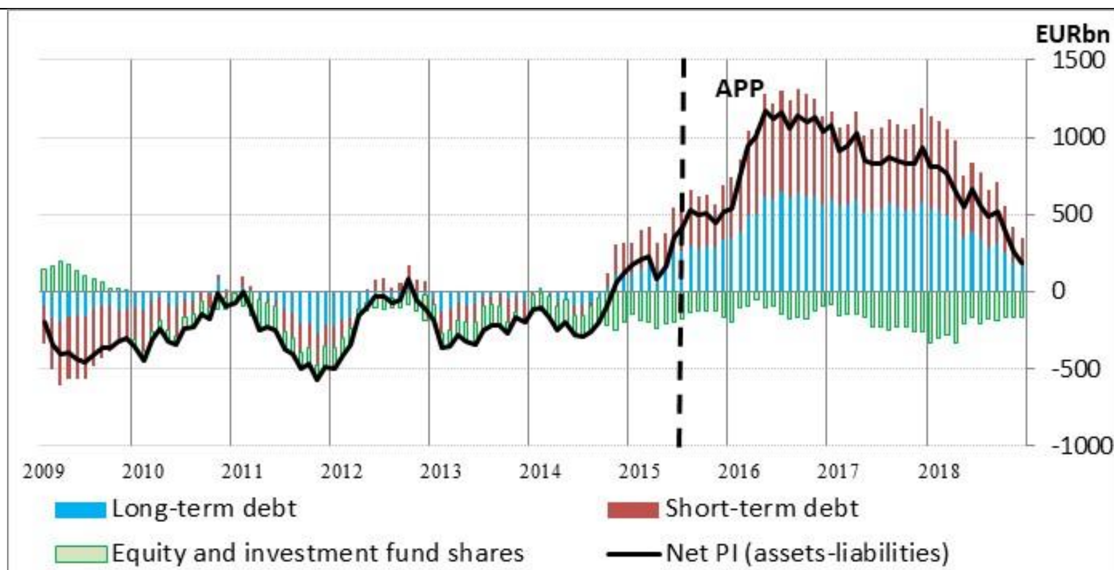
[14] Net portfolio investment flows are equal to the difference between the net increase in net foreign assets (or outflows) and the net incurrence of foreign liabilities (or inflows).

[15] Alternatively, the net incurrence of foreign liabilities exceeding the net acquisition of foreign assets.

[16] https://www.ecb.europa.eu/press/pressconf/2018/html/ecb.is181213.en.html. On the likely effects of the asset purchase programme (APP) on the financial account, see our previous years' reports and the references they contain. The likely effect of the end of the APP on the financial account of the euro area is expected to be the opposite of the effects seen during its implementation.

Chart 11 — Euro area 19 net portfolio investment flows by type of instruments



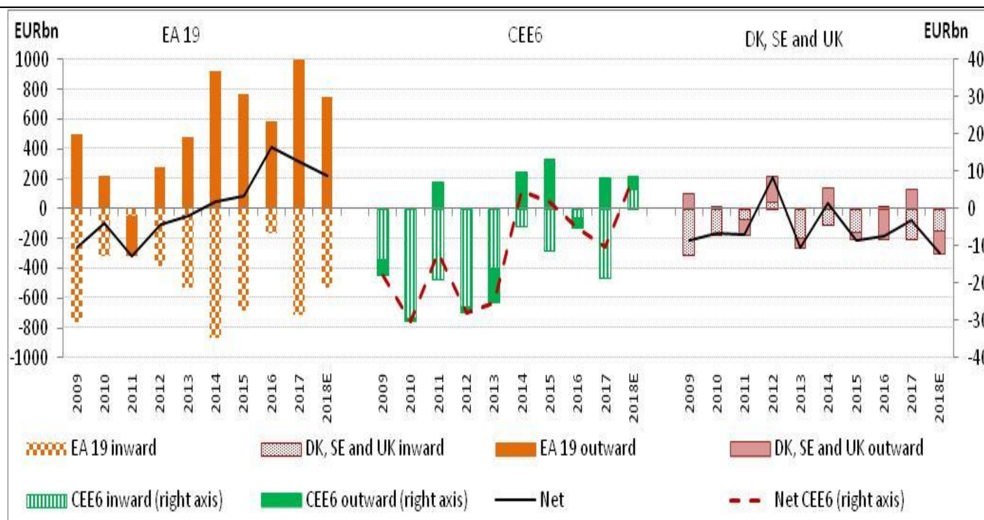
Source: ECB.

Notes: Net flows are equal to assets minus liabilities; Euro area 19 — fixed composition; APP — ECB's asset purchase programme; cumulative 12 months rolling sums.

Last update: February 2019, last available data point: November 2018.

By the end of 2018, the 19 euro area countries are expected to continue to be net exporters of portfolio investment, while Denmark, UK and Sweden are expected to be net recipients of foreign portfolio investment (though with a reversal of some previously made foreign investment in non-EU countries).

Chart 12 — Gross and net EU portfolio investment flows by groups of Member States.



Source: DG FISMA calculations based on EUROSTAT BoP Statistics. *Note*: Gross liabilities are multiplied by minus one.

2.4 Indicators for financial integration: home bias in equity and bond markets[17]

Home bias is the tendency to invest in domestic equity or bonds, despite the finance theory of the capital asset pricing model, which suggests that investors are expected to hold an internationally diversified portfolio.

Intra-EU and global home bias with macro data

This section investigates two types of home bias: (i) towards domestic investment compared to investment in the rest of the EU and (ii) towards domestic investment compared to the global market (both intra- and extra-EU). Accordingly, two indicators are constructed: an intra-EU home bias indicator and a global (intra-EU and extra-EU) home bias indicator. The first represents the tendency for EU Member States to invest domestically compared to foreign investment within the rest of the EU. The global home bias meanwhile refers to the tendency of each Member State to invest domestically compared to their total investments (in domestic assets and in foreign assets of both the other EU countries and non-European countries). Following Schoenmaker and Bosch (2008)[18] the home bias is measured by calculating the extent to which domestic instruments are over-weighted in a country's investment portfolio.

Chart 13 (left panel) reports yearly data for intra-EU home bias from 2000 to 2016 for both portfolio equity and debt. By construction, a lowering of the home bias shows a rise in financial integration among EU countries. Similarly, countries with a lower home bias tend to be more financially integrated than those with a relatively higher home bias.

In general, the two groups of euro area countries[19] tend to be more integrated with the rest of the EU with lower intra-EU home bias than the countries belonging to CEE11[20] or DK, SE and UK. For the years 2015 and 2016, both euro area regions tend to get closer in the evolution of their intra-EU home bias (debt + equity). They both stabilise around 70 %, close to the 65 % reached before the global financial crisis.

After 2008, the euro area 2 countries show an increasing trend in their debt intra-EU home bias, which stops in 2014 and reverses slightly in 2015 and 2016. Biannual data for 2017 confirm the decrease, especially for the euro area countries (Chart 13, right panel). On average, the overall intra-EU home bias for debt and equity is, however, rather stable as the equity home bias indicator acts in the opposite direction (see Error! Reference source not found.).

[17] This section was prepared by the JRC.

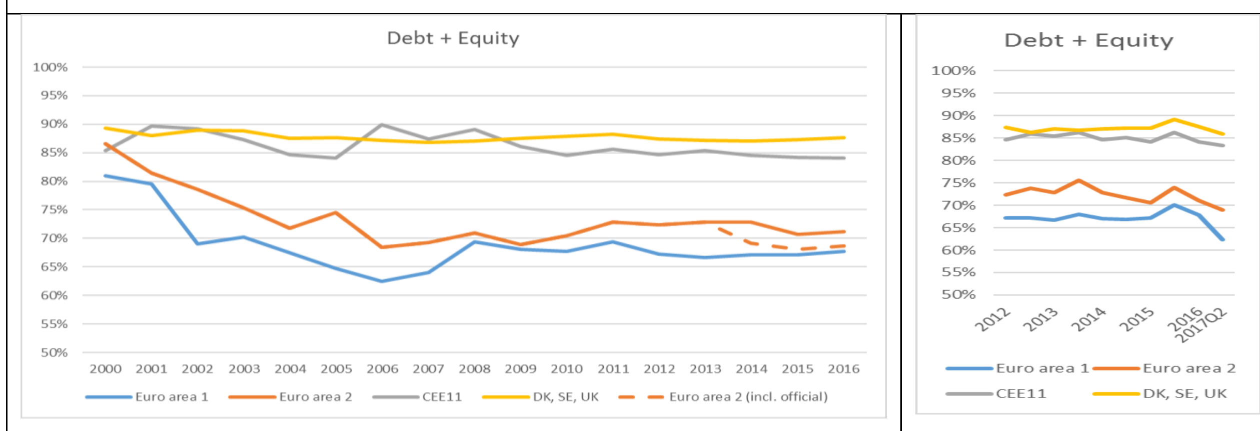
[18] Schoenmaker D., and T. Bosch (2008), Is Home Bias in Equities and Bonds Declining in Europe? Investment Management and Financial Innovations, 5(4), 90-102.

[19] The euro area countries can be grouped as follows: **euro area 1** countries include: Austria, Belgium, Finland, France, Germany, Luxembourg and the Netherlands; **euro area 2** countries include: Cyprus, Malta, Greece, Spain, Italy, Ireland and Portugal.

[20] CEE11 includes the more recently acceded central and eastern European Member States: Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

Chart 13 — Composite intra-EU home bias indicators for debt and equity

left panel annual data, right panel biannual data



Source: Left panel – JRC-ECFIN FinFlows database, BIS debt securities, EUROSTAT national account; right panel – IMF-CPIS data. JRC computations.
Note: By construction, a lowering of the home bias shows a rise in financial integration.

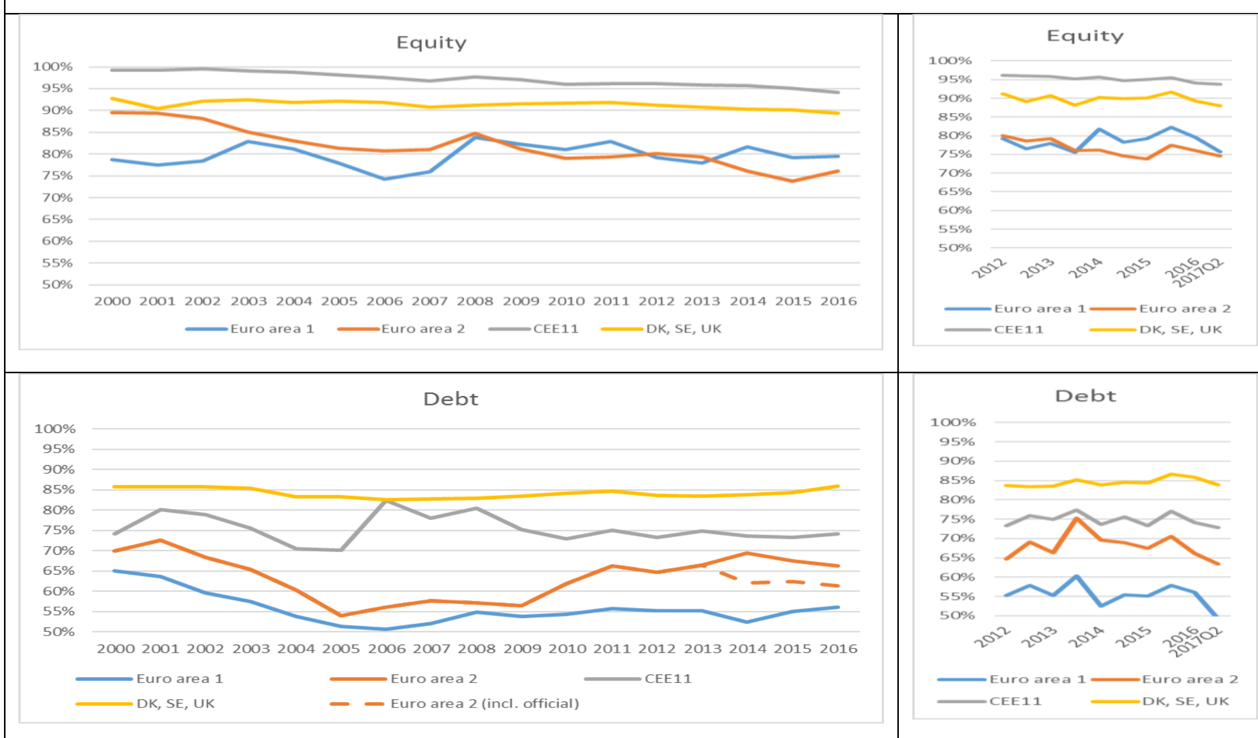
Portfolio investments usually refer to private investment in equities and debt securities. However, during the sovereign crisis, public (official) investments were also witnessed. The EU put in place initiatives such as the European Financial Stabilisation Mechanism (ESFM), the European Stability Mechanism (ESM) and the European Financial Stability Facility (EFSF) to support fragile EU countries most affected by the crisis. It is crucial to take these official investments into account (by convention within the category of portfolio investments) in order to properly evaluate cross-border capital movements[21].

In Chart 13 the difference between the dotted and the plain line for euro area 2 countries represents the home bias when considering only private investment (plain line) and when official investments through financial assistance programmes are also included (dotted line). This approach enables us to highlight the strong impact that financial assistance programmes had in increasing foreign investments within the EU (and the euro area in particular).

[21] Consistent bilateral data on these programmes are unfortunately not easily available. Data for each programme are retrieved individually and the bilateral positions must be reconstructed starting from loan level data. In terms of aggregated data, Eurostat records these investments within the *portfolio investments* category of the international investment positions data without distinguishing between private and official investments. IMF-CPIS data, on the contrary, do not include these official investments in their bilateral positions. The FinFlows database[21] fills the gap by collecting stock data for each of these official programmes and assigning them to each of the impacted countries to distinguish between private portfolio investments and official investments.

Chart 14 — Intra-EU home bias for equity (top row) and debt (bottom row)

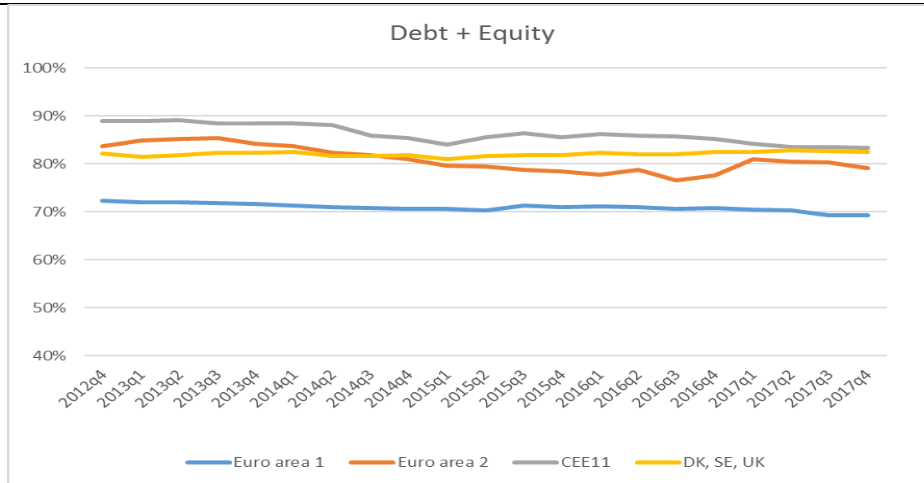
left panel annual data, right panel biannual data



Source: JRC-ECFIN FinFlows database, BIS debt securities, EUROSTAT national account. JRC computations.

Global home bias measures the preference for domestic investments compared to foreign investments, regardless of the counterpart (within the EU or beyond). Chart 15 shows the global home bias for all EU countries. Moving from an EU to a global focus changes the home bias mainly for euro area 2 countries. Euro area 2 shows a higher home bias when the global portfolio is taken into account. These countries (albeit with some missing data) are more integrated with respect to other EU countries than with respect to the rest of the world. This is not the case for the rest of the EU Member States, where openness to global markets does not significantly differ from openness to other EU Member States.

Chart 15 — Composite global home bias of EU countries for debt and equity



Source: IMF CPIS, BIS debt securities, EUROSTAT quarterly national account (nasq_10_f_bs_1) and quarterly investment positions (bop_iip6_q). JRC computations.
Notes: For debt, no data are available for CY, EE, LT, LV, MT, NL, SI and SK and only equity positions are considered. For equity, no data are available for IE.

Chart 16 — Global home bias for equity and for debt

Source: IMF CPIS, BIS debt securities, EUROSTAT quarterly national account (nasq_10_f_bs_1) and quarterly investment position (bop_iip6_q). JRC computations.
Notes: For debt no data are available for CY, EE, LT, LV, MT, NL, SI and SK and only equity positions are considered. For equity, no data are available for IE.

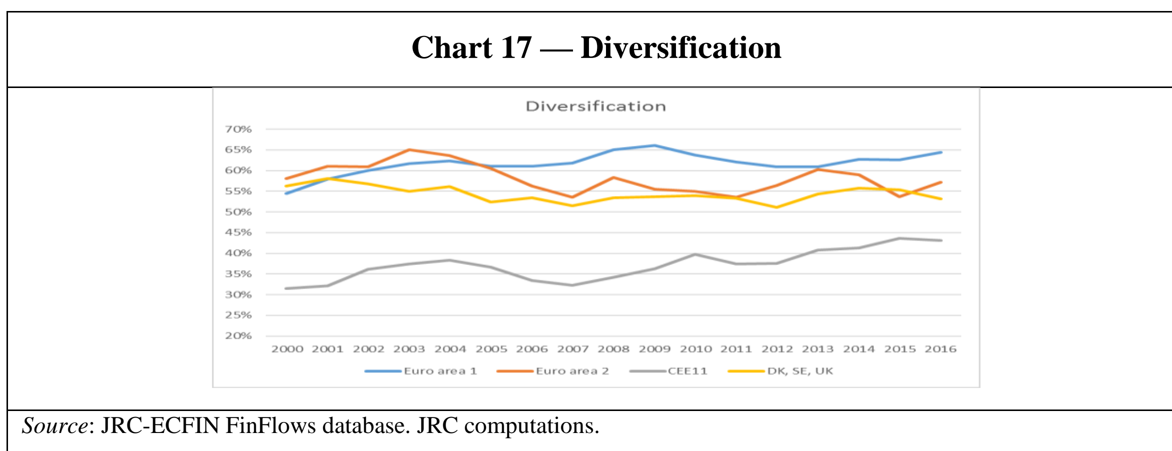
2.5 Sharing risks: diversification of portfolio investments within the EU and consumption smoothing

In order to measure inward and outward diversification in cross-border capital movements two indicators are constructed following Schoenmaker and Wagner (2011)[22]. The idea is that economies with more diversified outward investments cope better with domestic shocks as part of the shocks will be smoothed using income from foreign assets. Likewise, more diversified inward investment (liabilities) insulates domestic economies better from shocks generated abroad as only a fraction of the shocks are transmitted to the domestic economy via retrenchment of foreign investment (disinvestments). Private risk-sharing is therefore a very important feature of a fully-fledged Capital Markets Union and helps mitigate economic shocks in the euro area and beyond.

In order to construct the indices the dataset on bilateral cross-border stocks and flows compiled by JRC-ECFIN (FinFlows dataset) is used. The analysis is limited to the group of EU-28 countries and the available sample of annual data 2000-2016. The index is calculated for the total portfolio investments.

Chart 17 reports the average between inward and outward cross-border holdings for both the equity and debt market, while Chart 18 presents the same diversification indicators separately for inward and outward holdings. After 2006, euro area 1 tends to be more diversified than any other group of EU countries. Between 2012 and 2016, the diversification measure for this group of countries shows an increase from 60 % to 65 %, almost regaining the high of 2009. In contrast, euro area 2 shows a consistent decrease from 2013: from 60 % down to less than 55 %. A rebound appears to take place in 2016. However, the most significant and consistent trend is observed within the CEE11, which shows a relative increase in its diversification measure, despite a flattening in 2015-2016.

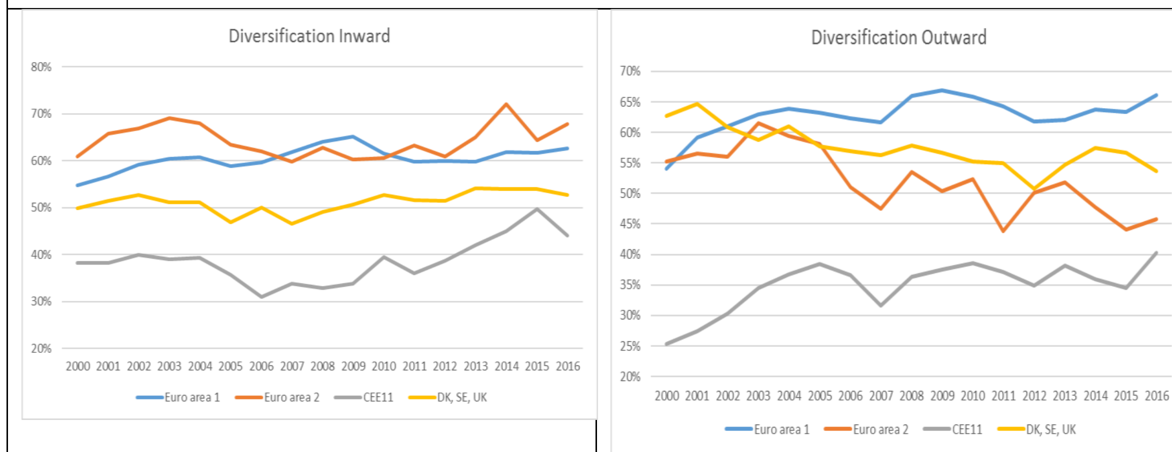
Chart 17 — Diversification



Source: JRC-ECFIN FinFlows database. JRC computations.

[22] Schoenmaker D., and W. Wagner (2011), The Impact of Cross-Border Banking on Financial Stability, Tinbergen Institute Discussion Paper TI-11-054.

Chart 18 — Inward and outward diversification



Source: JRC-ECFIN FinFlows data and JRC computations.

3 LEGAL FRAMEWORK UNDERLYING THE FREE MOVEMENT OF CAPITAL AND PAYMENTS

3.1 Legal framework

The principle of free movement of capital lies at the heart of the single market and is one of its four fundamental freedoms. The Treaty on the Functioning of the European Union (TFEU) does not contain an explicit definition of capital movements. However, in its jurisprudence the Court of Justice of the European Union (CJEU) has consistently established a broad definition of capital movements[23]. According to this jurisprudence, capital movements cover many operations, including:

- FDI, real estate investments and purchases;
- securities investments (e.g. in shares, bonds, bills and unit trusts);
- transactions in securities on capital markets, admission of securities to capital markets;
- operations in units of collective investment undertakings;
- premiums and payments in respect of life and credit assurance; and
- granting of loans and credits and other operations, including personal capital operations such as dowries, inheritances and legacies, gifts and endowments.

[23] Based on the nomenclature annexed to Council Directive 88/361/EEC.

As a rule, all restrictions on the movement of capital between Member States, but also between Member States and non-EU countries, are prohibited (Article 63 TFEU). The CJEU has interpreted the term 'restriction' to mean all measures liable to prohibit, limit or deter free movement[24]. However, the TFEU provides for the possibility to restrict capital movements, for the reasons referred to in Article 65 TFEU and, for non-discriminatory restrictions, for overriding reasons in the public interest. In particular, Article 65 TFEU provides that the free movement of capital is without prejudice to certain powers of Member States. These include: a) the power to apply the relevant provisions of their tax law that distinguish between taxpayers who are not in the same situation with regard to the place of residence or the place where the capital is invested, and b) the power to take precautions and supervisory measures, especially in the fields of taxation and the prudential supervision of financial institutions. Moreover, Article 65(1)(b) TFEU preserves the power of Member States 'to take measures which are justified on grounds of public policy or public security'.

In any case, restrictive measures must respect the principle of proportionality. As such, they must be suitable to attaining the objective sought, they must not go beyond what is necessary to achieve that objective and cannot be replaced by less restrictive alternative means. Moreover, national measures must comply with other general principles of EU law, such as legal certainty, and with the fundamental rights[25]. Furthermore, the exceptions provided in the TFEU must not constitute a means of arbitrary discrimination or a disguised restriction on the free movement of capital and payments (Article 65(3) TFEU).

Different considerations apply to the movement of capital to and from non-EU countries. The CJEU has stressed that it 'takes place in a different legal context' from that which exists within the EU. Consequently, under the Treaty additional justifications may be acceptable in the case of non-EU country restrictions[26]. Justifications may also be interpreted more broadly[27]. Moreover, and in practice more importantly, any restrictions on certain capital movements (direct investment, real estate, the provision of financial services and the admission of securities to capital markets) existing before the liberalisation of capital movements are grandfathered under Article 64(1) TFEU. The relevant date is 31 December 1993 for all Member States except Bulgaria, Estonia and

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[24] Judgement of 6 March 2018, *SEGRO and Horváth*, joint cases C‑52/16 and C‑113/16, EU:C:2018:157, paragraph 65

[25] Judgement of 5 July 2012, *SIAT*, C-318/10, EU:C:2012:415, paragraph 58; Judgement of 30 April 2014, *Pfleger*, Case C- 390/12, EU:C:2014:281, paragraph 35

[26] Judgement of 18 December 2007, *Skatteverket*, cases C-101/05, paragraph 36; Judgement of 12 December 2006, *Test Claimants in the FII Group Litigation*, C-446/04, EU:C:2006:774, paragraph 171

[27] See, for example, Judgement of 12 December 2006, Test Claimants in the FII Group Litigation, C-446/04, EU:C:2006:774

Hungary (31 December 1999) and Croatia (31 December 2002). This means that restrictions on certain capital movements in place before these dates affecting third country nationals cannot be challenged on the basis of the principle of the free movement of capital under the Treaty.

The Treaty also provides for certain restrictions that can be adopted by the EU under certain conditions. The Council may, by means of a Regulation, interrupt or reduce, in part or completely, the economic and financial relations with one or more non-EU countries if deemed necessary to achieve the objectives of the Common Foreign and Security Policy (Article 215(1)). Such restrictive measures or sanctions may affect in particular exports, imports, transfers of funds, investment and access to the EU's capital markets. Furthermore, Article 75 TFEU provides for a derogation from the free movement of capital and payments for the purposes of achieving objectives in the area of freedom, security and justice as regards preventing and combating terrorism and related activities. Such restrictive measures may include freezing the funds, financial assets or economic gains of companies, individuals, groups or non-state entities. Finally, the Council may take temporary safeguard measures in exceptional situations when movements of capital with third countries cause, or threaten to cause, serious difficulties for the operation of the Economic and Monetary Union. The general principles of EU law, including the principle of proportionality and the respect for fundamental rights, apply also in this context.

3.2 Framework for investment protection

In July 2018, the Commission adopted a Communication on the protection of intra-EU investment[28], which gives an overview on the rules regarding investment protection and the remedies available in that regard.

With this communication, the Commission aims to recall the protection enjoyed by investors under existing EU law. This in turn should increase awareness and confidence in the EU's investment environment by making existing intra-EU investors' rights more visible for national authorities (administrations and judges) and investors.

It will also help prevent Member States from adopting measures that would infringe EU law, help investors to invoke their rights before administrations and national courts, and assist legal practitioners in applying EU rules. At the same time, the Communication clarifies that investors' rights under EU law are not absolute. Instead, they need to be balanced with legitimate public policy objectives such as environmental concerns, in a proportionate manner, and in compliance with EU law.

In the abovementioned Communication, the Commission also explains the implications of the *Achmea* judgment[29], in which the CJEU ruled that investor-state arbitration

[28] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2018%3A547%3AFIN

contained in bilateral investment treaties (BITs) between Member States is not compatible with EU law. See section 4.3.1 for more details.

EU law enables, encourages and protects investments in many ways. First, EU investors benefit from the fundamental freedoms of the single market. The free movement of capital under the Treaty guarantees that capital can circulate freely throughout the EU as explained in section 3.1. Investors enjoy the freedom, among other things, to establish a business, invest in companies and provide services across borders.

Second, investors can also rely on the fundamental rights protected by the Charter of Fundamental Rights of the EU (for instance, the right to property, access to justice and non-discrimination). They can also rely on the applicable general principles of EU law, such as the principle of proportionality, legal certainty and the protection of legitimate expectations.

Third, investors are protected through a large body of sector-specific legislation covering areas such as financial services, transport, energy, telecommunications, public procurement, professional qualifications, intellectual property and company law.

The enforcement of those rights is guaranteed by national courts. The preliminary ruling procedure ensures that national judges cooperate with the Court of Justice to ensure the correct and uniform interpretation of EU law. The Commission may launch infringement procedures if a Member State fails in securing rights of individuals deriving from EU legislation. See section 3.3 for more details.

At the same time, EU law allows markets to be regulated to pursue legitimate public interests such as public security, public health, social rights, consumer protection and environmental protection, which may also have consequences for investments. Public authorities of the EU and of the Member States have a duty and a responsibility both to protect investments and to regulate markets. The EU and the Member States may therefore legitimately take measures to protect those interests, which may have a negative impact on investments. However, they can do so only in certain circumstances, under certain conditions and in compliance with EU law, as explained in section 3.1.

3.3 Infringement proceedings

In its Communication on EU Law: Better results through better application[30], the Commission announced a new approach to its infringement policy to underpin the achievement of EU policy objectives. As a priority, the Commission targets problems where its enforcement action can make a real difference and provide real added value to individuals and businesses.

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[29] https://curia.europa.eu/jcms/upload/docs/application/pdf/2018-03/cp180026en.pdf

[30] https://ec.europa.eu/info/publications/communication-commission-eu-law-better-results-through-better-application_en

In line with the Commission's priorities and its political commitment to be more strategic in enforcing EU law, the Commission decided to act firmly on infringements that risk undermining the four fundamental freedoms. It also opted to close cases where doing so appeared appropriate from a policy point of view. Against this background, the Commission decided to close two infringement cases relating to investment limits in certain energy companies.

Another area where the Commission has taken action as guardian of the Treaties to ensure free movement of capital is direct taxation. Although direct taxation is primarily the responsibility of Member States, they must act in compliance with EU law, including the laws on the free movement of capital. During the reporting period[31], the Commission launched seven infringement proceedings under Article 63 TFEU and Article 40 of the European Economic Area Agreement against the United Kingdom, Latvia, France, Belgium and Portugal by sending letters of formal notice.

During the same period, the Commission closed three proceedings on tax restrictions on the free movement of capital. By 1 November 2018, there were 39 open infringement proceedings against Member States for violations in the field of direct taxation in relation to the free movement of capital.

In 2017, the Commission brought two actions against France and Belgium to the CJEU for, among other things, violations of the principle of free movement of capital in the field of direct taxation.

In the first case, the Court decided that France had failed to fulfil its Treaty obligations by refusing to take into account for the reimbursement of the advance payment ('précompte mobilier') made by a resident company in respect of dividends paid by a non-resident company via a non-resident subsidiary, the tax incurred by that second company on the profits underlying those dividends, although the national mechanism for the avoidance of economic double taxation permits offsetting the tax levied on the dividends distributed by a company at every level of a purely domestic chain of interests[32].

In the second case, the Court declared that Belgium had failed to fulfil its obligations by retaining provisions, under which the rental income of Belgian taxpayers from foreign immovable property is calculated based on the actual rental value, but from property located in Belgium – based on the cadastral value[33].

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[31] From 1 January 2017 to 1 November 2018

[32] Judgment of 4 October 2018, Commission v. France, Case C-416/17, EU:C:2018:811

[33] Judgment of 12 April 2018, Commission v. Belgium, Case C-110/17, EU:C:2018:250

4 MAIN DEVELOPMENTS SUPPORTING THE FREE MOVEMENT OF CAPITAL AND THE FREEDOM OF PAYMENTS

4.1 Capital Markets Union

The Capital Markets Union is an important priority for the European Union and an essential part of the third pillar of the Investment Plan for Europe[34]. The Capital Markets Union aims to break down barriers that block cross-border investments in the EU and make it easier for companies and infrastructure projects to get the finance they need, regardless of where they are located. A single capital market benefits the EU as a whole and is essential to delivering on the Commission's priority to boost growth and innovation. Moreover, efficient capital mobility strengthens the Economic and Monetary Union and the international role of the euro by supporting economic convergence. It also helps to cushion economic shocks in the euro area and beyond, making the European economy more resilient.

Most of the measures announced in the 2015 Capital Markets Union Action Plan and in the 2017 mid-term review of the Capital Markets Union Action Plan have been delivered by the Commission, including the legislative proposals that contribute to removing barriers to cross-border investments.

The Prospectus Regulation adopted in June 2017, the Regulation on European Venture Capital Funds of October 2017 and the Regulation on Simple, Transparent and Standardised (STS) Securitisations of December 2017 simplify the issuance of securities across the single market and help capital to flow to the most rewarding projects.

The Commission has presented an overview of the legislative proposals and their state-of-play in the progress report of 28 November entitled "Communication on Capital Markets Union: time for renewed efforts to deliver for investment, growth and a stronger role of the euro"[35].

In addition to the legislative proposals, the Commission has made substantial progress on many of the non-legislative actions included in the Capital Markets Union Action Plan and the mid-term review. A further progress report will be presented in 2019.

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[34] More details are available at: https://ec.europa.eu/priorities/jobs-growth-and-investment/investmentplan_en

[35] https://ec.europa.eu/info/publications/181128-cmu-progress-report_en

4.2 Addressing national barriers to the free movement of capital

4.2.1 Expert Group on barriers to free movement of capital

During the reporting period, the Commission continued to work with an expert group of Member State representatives. The aim was to address national barriers to the free movement of capital in support of the Capital Markets Union project and to complement the European semester initiatives in order to tackle obstacles to investment.

In 2017, the Commission published a report[36] taking stock of the results of the mapping exercise and inviting Member States to tackle unjustified barriers stemming from national legislation or administrative practices that either go beyond EU rules ('gold-plating') or are in areas of mainly national competence. The report contained a roadmap of measures that the Member States then endorsed in the ECOFIN meeting of 23 May 2017[37]. In the reporting period, the Commission focused on the implementation of the roadmap.

The following details the state of play for implementing the measures included in the joint roadmap:

- burdensome withholding tax (WHT) relief procedures: a code of conduct was published in December 2017 and a public hearing was held in January 2018. Two implementation meetings took place in 2018. See section 4.2.2 for more details;
- barriers to the cross-border distribution of investment funds: legislative proposals addressing cross-border barriers to the distribution of investment funds were adopted by the Commission on 12 March 2018[38]. See section 4.2.3 for more details;
- removing residence requirements for the managers of financial institutions when unjustified and disproportionate: the issue was thoroughly discussed and one Member State reported plans to change its legislation;
- working to identify drivers for cross-border investment by pension funds and promote opportunities under the Investment Plan for Europe: the Commission will present the results of a study on insurance/pension fund investment in equity in 2019; and
- working on the financial literacy of consumers and SMEs: a report summarising the work of the subgroup has been published[39]. At the request of the Financial

[36] https://ec.europa.eu/info/files/170227-report-capital-barriers_en

[37] https://ec.europa.eu/info/files/170519-roadmap-national-capital-barriers_en

[38] https://ec.europa.eu/info/law/better-regulation/initiatives/com-2018-92_en

[39] http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=37326&no=1

Services Committee (FSC) in May 2018, the follow up work continued under other groups[40].

Given the lack of appetite from Member States, it was agreed at the Economic and Financial Committee (EFC) to put the expert group on hold. The expert group can be reconvened in 2019 to present an update on measures identified and discuss any other topics that arise in the meantime.

4.2.2 Withholding tax

The Code of Conduct on Withholding Tax[41], published in 2017, is one of the main deliverables of the Capital Markets Union Action Plan in the area of taxation. It seeks to address the long-standing problem of long delays and costs in recovering taxes withheld in the country of investment. Burdensome procedures for recovering tax withheld on portfolio investments have long been identified by Member States and the Commission as a barrier to a true EU capital market. They penalise cross-border investment, disrupt financial processes such as clearing and settlement, and increase the cost of cross-border trading. The resulting misallocation of financial resources undermines cross-border investments, which in practice are taxed twice (despite bilateral taxation treaties).

The 2017 report and the joint roadmap identified a series of best practices on WHT recovery proceedings (in addition to relief at source). They also reiterated, as a way forward, the need to work together with national tax experts on a code of conduct.

The 2017 code is a non-binding document that calls for voluntary commitments by Member States. It should be considered as a compilation of approaches to improve the efficiency of current WHT procedures, in particular for refunds of WHT to which Member States can add or adapt elements to meet national needs or circumstances.

A public hearing took place on 30 January 2018[42] to present the code to the public and raise awareness among key stakeholders.

In the reporting period, two implementation meetings took place (21 June and 5 November) to verify the state of play and the Member States' progress in implementing the code.

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[40] The Government Expert Group on Retail Financial Services (GEGRFS): http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetail&groupID=2021&NewSearch=1&NewSearch=1

[41] https://ec.europa.eu/taxation_customs/sites/taxation/files/code_of_conduct_on_witholding_tax.pdf

[42] https://ec.europa.eu/info/events/finance-180130-simpler-withholding-tax-procedures_en

4.2.3 *Cross-border distribution of funds*

The legislative package on cross-border distribution of investment funds, adopted by the Commission on 12 March 2018, is intended to improve the functioning of the single market for European investment funds. The EU investment fund market remains predominantly national. 70 % of the total assets under management held by investment funds[43] are registered for sale only in their domestic market. Only 37 % of Undertakings for the Collective Investment in Transferable Securities (UCITs) and about 3 % of Alternative Investment Funds (AIFs) are registered for sale to more than three Member States. It is expected that a more fully integrated European market will reduce market fragmentation, bring greater economies of scale and increase competition across the EU. This in turn should lead to more and better choice for investors.

The Commission proposals contain the following measures:

The Regulation introduces a transparency framework on national provisions concerning marketing requirements and regulatory fees levied by national competent authorities. Moreover, it harmonises the process and requirements for the verification of marketing communications by competent authorities and introduces principles to ensure more consistency in the way regulatory fees are determined. Finally, the Regulation enlarges the European Securities and Markets Authority's (ESMA) central database to include all management companies, the AIFs and UCITS they manage as well as the Member States where those funds are marketed. This will assist ESMA in monitoring and assessing market developments in the investment funds sector.

The Directive – which amends the UCITS and AIFM Directives – modernises the existing requirements regarding facilities for making payments to unit-holders, repurchasing or redeeming units and making information available to investors. The management company will be able to choose how these facilities are provided: either physically, by telephone or electronically. In addition, the Directive further harmonises the procedures for updating notifications and introduces requirements and procedures for discontinuing the marketing of units or shares in one or several host Member State(s).

The European Parliament and the Council of the EU reached a political agreement on the proposal in February 2019.

[43] EU investment funds have seen rapid growth, resulting in a total of EUR 14 310 billion in assets under management in June 2017, of which 60.8% is invested in UCITS and 39.2% in AIFs.

4.3 Intra-EU investment protection

4.3.1 Towards termination of intra-EU bilateral investment treaties

In its judgment of 6 March 2018 in the Achmea case, the Court of Justice confirmed the Commission's view that investor-to-state arbitration in an international agreement concluded between Member States is not compatible with EU law. The Court explained that, when applied in an intra-EU context, such a mechanism undermines the system of legal remedies provided for in the EU Treaties for resolving such disputes. It therefore poses a threat to the autonomy of EU law, its effectiveness and primacy, and the principle of mutual trust between the Member States. The Bilateral Investment Treaties[44] among EU Member States (intra-EU BITs) containing investor-to-state arbitration clauses must therefore be legally terminated in order to ensure legal certainty. The Commission assists the Member States in that process which is ongoing.

The Achmea judgment is also relevant for the investor-state arbitration mechanism in intra-EU relations based on Article 26 of the Energy Charter Treaty – a plurilateral investment treaty initiated by the EU to stimulate investments in the energy sector. That Article, if properly construed, does not apply to intra-EU relations. If however it were construed to apply to intra-EU relations, it would be contrary to the Treaty in light of the Achmea judgment. The consequences of that judgment for Article 26 of the Energy Charter Treaty are explained in the Commission Communication on the protection of intra-EU investment[45].

The Achmea judgment has important implications for investors operating inside the EU. It confirmed that EU investors cannot rely on intra-EU bilateral investment treaties and cannot resolve disputes with EU Member States in arbitration tribunals. Moreover, investors should not initiate new intra-EU arbitration proceedings in future disputes with EU Member States. Instead, they have the possibility to enforce their rights in national courts in the EU. Arbitration tribunals established to resolve disputes in relations between an investor established in the EU and an EU Member State should decline jurisdiction given the lack of valid offer to arbitrate. Clearly, the Achmea judgment only concerns intra-EU disputes and different legal considerations apply to external EU investment policies.

The Achmea judgment confirms a long-standing position of the European Commission that intra-EU BITs are incompatible with EU law. By setting up an alternative system of dispute resolution, intra-EU BITs take litigation concerning national measures and involving EU law away from national judiciaries. They entrust this litigation to private

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[44] Bilateral investment treaties are international agreements that typically grant protection to investment by nationals and companies of one state in another one. These treaties focus on investor protection, for example by means of compensation for expropriation and provide for a system that allows the settlement of investment disputes between investors and the country where the investment is made.

[45] https://ec.europa.eu/info/publications/180719-communication-capital-movements_en

arbitrators who cannot properly apply EU law, in the absence of indispensable judicial dialogue with the Court of Justice. Furthermore, intra-EU BITs confer rights only in respect of investors from one of the two Member States concerned, in conflict with the principle of non-discrimination among EU investors within the single market under EU law. For these reasons, the European Commission had consistently taken the view that intra-EU BITs are incompatible with EU law. Through its reasoned opinions of 23 September 2016, the Commission sent a formal request to Austria, the Netherlands, Romania, Slovakia and Sweden to terminate their intra-EU BITs.

Following the Achmea judgment, the Commission has intensified its dialogue with all Member States, calling on them to take action to formally terminate their intra-EU BITs. The Commission is ready to assist Member States to ensure an orderly and coordinated termination process. As a first step, on 15 January 2019 the Member States committed to terminating all bilateral investment treaties between them. In declarations signed by their representatives, they agreed on the legal consequences regarding intra-EU bilateral investment treaties following the judgment of the Court of Justice in the Achmea case. The declarations are important to provide additional legal clarity for investors and arbitral tribunals quickly. They aim, among other things, at preventing the enforcement of existing arbitral awards contrary to EU law and the commencement of new arbitration proceedings that would be incompatible with EU law, pending the formal termination of all intra-EU BITs. The second step is the negotiation of a plurilateral termination treaty of intra-EU BITs, which the Commission is facilitating.

In the aftermath of the Achmea judgment, the unlawfulness of intra-EU investor-state arbitration may result in the perception that EU law does not provide for adequate substantive and procedural safeguards for intra-EU investors. However, the EU legal system protects cross-border investors in the single market. At the same time, it ensures that other legitimate interests are duly taken into account. The Communication on protection of intra-EU investment clarifies how EU law protects investors' rights and how they can enforce these rights before administrations and courts in the EU Member States. See section 3.2 for more details.

On 17 December 2018, the European Commission held a workshop for EU investors on investor protection in the EU. The workshop raised investors' awareness of their rights under EU law as laid out in the communication of 19 July 2018. It also gave companies the opportunity to provide feedback on their practical experiences with cross-border investments in the EU.

4.3.2 Prevention and amicable resolution of disputes between investors and public authorities

The Commission has been exploring whether mediation could offer a way to ensure a cost-effective, flexible and quick resolution of some disputes between investors and public authorities. Overall, stakeholders' feedback during the public consultation[46] confirmed that amicable dispute settlement mechanisms and mediation could be seen as a valuable additional tool for settling investment disputes. For stakeholders, the main advantages of mediation appear to be its potential to avoid escalation of the dispute, thus reducing the duration and costs while widening the range of potential outcomes. They also noted its potential to help preserve the ongoing relationship between the investor and the public authorities of the host state. The consultation provided a more precise overview of the typical situations that may lead to the escalation of disputes as well as an overview of the works different Member States have undertaken in the field of mediation. However, it also showed that there is currently very little data available at national level on the impact of mediation in investment disputes. This lack of data could be explained by the fact that only a few EU Member States have recently enacted legislation introducing mediation, including for administrative disputes not covered by the Mediation Directive.

The analysis also showed the limitations of mediation for the settlement of investment disputes. For example, it does not appear to be suitable for solving most of the disputes relating to modifications of national regulatory frameworks.

While the findings of the consultation will be very valuable to the reflection on the post-Achmea investment protection framework, they did not provide sufficient elements at this point in time to justify EU legislative action on an EU mediation framework.

4.4 The international role of the euro

With the adoption of the Communication 'Towards a stronger international role of the euro' in December 2018[47], the Commission opened a new frontier in the overall agenda of the Economic and Monetary Union. The ambition is to secure the integrity and stability of the euro system internally and provide opportunities for further international use of the euro. Strengthening the euro's international role should be conceived as part of Europe's broader commitment to an open, multilateral and rules-based global economy.

In this context, financial markets and infrastructure in the euro area play an integral role in offering opportunities for enhancing the international role of the euro. They do so by

[46] The consultation took place between 31 July 2017 and 30 November 2017: https://ec.europa.eu/info/consultations/finance-2017-investment-protection-mediation_en

[47] The Communication was published on 5 December 2018: https://ec.europa.eu/commission/publications/towards-stronger-international-role-euro-commission-contribution-european-council-13-14-december-2018_en

providing dependable and stable financial services and transaction opportunities. Ultimately, market participants choose which currencies to use on the international stage but the aim is to increase the attractiveness of the euro for market participants and the attractiveness of the euro-area economy for investors more broadly.

The Commission achieves this by proper regulation in support of so-called deep and liquid financial markets where people can buy or sell large quantities of financial assets and contracts more efficiently, i.e. at lowest cost and without adversely affecting prices. The Commission also works to support financial stability and safeguard infrastructure to allow payments to go through and financial assets and contracts to change hands in a secure and uninterrupted manner (i.e. clearing and settlement of transactions). The existence of such dependable financial services makes the euro an attractive currency to use.

Several of the Commission's key policies are designed to foster financial market developments that are conducive to a greater role of the euro, either directly or indirectly. In particular, the Banking Union and the Capital Markets Union are two mutually reinforcing initiatives that can take the single market further, increasing the attractiveness of the euro as a dependable means of conducting business. Building on the financial stability provided by an effectively functioning Banking Union, one key objective of the Capital Markets Union lies in achieving deeper and more liquid markets. To do so, Capital Markets Union initiatives aim to diversify sources of financing, eliminate barriers to cross-border investments and offer more investment opportunities.

Although the Banking Union and the Capital Markets Union are the main vehicles for achieving an attractive base for the use of the euro in financial transactions, the Communication lists some targeted measures in the financial sector that can strengthen its role, as well as the financial autonomy of the euro area:

- First, the Commission seeks to make further use of European market infrastructure to widen the use of the euro in derivatives contracts, i.e. financial instruments whose value depends on the value of other underlying variables. The objective would be to match buy and sell orders (so-called clearing) for a larger set of over-the-counter derivatives;
- Second, the Commission would like to underpin confidence in the use of euro area financial markets by ensuring the availability of trustworthy interest-rate benchmarks, which act as reference rates in many financial contracts;
- Third, the Commission supports a fully integrated instant payment system in the EU, to reduce the risks and the vulnerabilities of retail users of payment systems.

In addition, the Communication proposes investigating further policies that can increase the use of the euro in foreign exchange markets, energy contracting and transactions in certain strategic sectors. For example, to see to what extent it is possible to increase the use of the euro when trading certain commodities, such as oil and gas, raw materials and food commodities, as well as in the sector of transport manufacturing – aircraft, maritime

transport and railways. The Commission applied a coordinated approach in launching these consultations by the end of January 2019[48].

An increased international role for the euro should lead to more capital movements across the euro area border. The euro is unchallenged as the second most important currency in the international monetary system. It is also used as a reserve currency, for issuing international debt, taking up international loans, and as a global payment currency. To the extent the euro would be used even more in these activities, more capital would have to be allocated to euro denominated assets as a store of value and to facilitate international payments, but also for investment purposes. These portfolios would have to be managed, which would lead to additional capital flows. In fact, free capital flows is one of the prerequisites for strengthening the international role of the euro.

4.5 Payment services in the single market

4.5.1 Revised Directive on payment services ((EU)2015/2366)

With the adoption of Directive 2007/64/EC on payment services in 2007, the EU created a comprehensive legal framework on retail payments. The Directive introduced the concept of payment institutions to bring more competition to a market that was previously dominated by credit institutions.

Since then, the payment market has evolved significantly. Today, many innovative players are operating in the market. As a result, the market has become more competitive than ever before. Innovation has also led to new types of payment services, which were not regulated under Directive 2007/64/EC.

In 2015, the Directive was revised and modernised to take account of these new technological developments and to introduce more enhanced security measures to make electronic payments safer and more secure. The revised Directive ((EU) 2015/2366) came into force at the beginning of 2018 and is accompanied by a range of delegated acts. The most important of these is Commission Delegated Regulation (EU) 2018/389[49]. Once this delegated act enters into force in September 2019, banks and other account-servicing payment service providers will have to apply stricter security measures to their payments. They must also put in place communication interfaces that will allow providers of new types of payment services to access – with the explicit consent of the account holder who makes use of these services – the data of that account holder. Currently, several market initiatives are developing dedicated interfaces to that end (so-called APIs). These developments will have a catalyst effect on innovation in the area of

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[48] See https://ec.europa.eu/info/business-economy-euro/euro-area/international-role-euro_en#consultations

[49] Commission Delegated Regulation (EU) 2018/389 of 27 November 2017 supplementing Directive (EU) 2015/2366 of the European Parliament and of the Council with regard to regulatory technical standards for strong customer authentication and common and secure open standards of communication.

payments and other financial services, leading to the development of new payment and account-related services, eventually driving the market towards open banking.

4.5.2 Regulation (EC) No 924/2009 on cross-border payments

Regulation (EC) No 924/2009 on cross-border payments equalised, across the EU, fees for cross-border payments in euro within the EU with domestic payments in euro (i.e. payments in euro within the same Member State). Non-euro area Member States, although covered by the Regulation, did not benefit from the effects of that Regulation: in these Member States, domestic payments in euro are either very expensive or simply do not exist. As a consequence, people and businesses in these non-euro area EU Member States pay high fees whenever a payment crosses the border of their country or when people travel and pay abroad. These high costs are an impediment to the completion of the single market and create two categories of payment service users in the EU.

In March 2018, the Commission tabled a proposal seeking to bring the benefits of Regulation (EC) No 924/2009 to people and businesses in Member States outside the euro area and put an end to the high costs of intra-EU cross-border transactions in euro made from non-euro area Member States. As a result of the amendments contained in this proposal, the citizen or company transferring euros from these countries would also pay nothing – or almost nothing – as for domestic transactions. A political agreement between the European Parliament and the Council was reached on the proposal in December 2018.

The proposed amendments to Regulation (EC) No 924/2009 also establish additional transparency obligations for currency conversion practices in line with Articles 45 and 59 of Directive 2015/2366 on payment services in the single market. These amendments seek to enhance transparency for consumers by disclosing the full cost of a cross-border transaction. They also help them compare currency conversion service offers before starting a payment transaction involving a currency conversion. This transparency will particularly benefit consumers who travel to Member States with a currency that is different from that of their home country.

4.5.3 Single Euro Payments Area (SEPA)

Regulation (EU) No 260/2012 establishes technical and business requirements for credit transfers and direct debits in euro. The Regulation, known as the Single Euro Payments Area (SEPA) Regulation, was adopted in 2012 and has been another major step forward in the proper functioning of the single payments market. It has created an integrated market for electronic payments in euro, by migrating to EU-wide credit transfers and direct debits and the introduction of IBAN. This migration has led to significant savings as banks no longer encounter the high costs of running both ‘legacy’ and SEPA products in parallel. In addition, since 2012 payees must ensure that where their accounts are

reachable for domestic credit transfers and direct debits, those accounts are also reachable for cross-border credit transfers and direct debits. IBAN discrimination based on the location of the account is no longer permitted. Payers with an account in a country other than that of the payee should be able to make a SEPA transfer from their account just like any other payer that has an account in the country of the payee.

At the end of 2017, the Commission issued the SEPA report on the application of the Regulation. The report concluded that, overall, the SEPA migration has been a success. The report also identified a number of smaller issues, including the problem of IBAN discrimination, in a number of cases, including by utility companies and telecom providers. Another issue highlighted in the report was the fact that some Member States did not designate a competent authority capable of addressing non-compliance by payees. Furthermore, in cases where the Member State had designated a competent authority, that authority was sometimes unable to enforce the SEPA Regulation, specifically in cases of IBAN discrimination. In 2018, the Commission services focused their efforts on resolving these remaining obstacles to ensure that SEPA credit transfers and direct debits are accepted, irrespective of whether they are domestic or cross-border, including in the cases identified. In the follow-up of specific complaints, the Commission contacted the Member States concerned to ensure that the Regulation is also respected by the payees concerned. In the case of three Member States, the Commission launched an EU-Pilot to enquire which steps the Member States concerned take to ensure that a competent authority is designated to address the non-compliance of the Regulation by payees.

4.6 Direct taxation and free movement of capital

The Commission's agenda to tackle tax evasion and avoidance has achieved notable success. This work on fairer taxation is important to remove distortions that many companies face due to the aggressive tax planning of their competitors. A coordinated EU approach also helps to prevent a mixture of national anti-abuse measures from creating new obstacles for businesses in the single market. Recent policy initiatives in the field of taxation are therefore essential for more integrated capital markets in the EU.

All of the initiatives announced in the 2015 action plan for fair and efficient corporate taxation in the EU have now been launched with the aim of ensuring that every company pays tax where it makes its profits. Several initiatives have already been adopted to strengthen the EU anti-abuse provisions (in particular the Anti-Tax Avoidance Directives[50]) and to boost tax transparency. Most recently, on 25 May 2018 the Member States adopted an amendment to the Directive on administrative cooperation[51] to make intermediaries (e.g. advisers, consultants, lawyers and accountants) liable to report to tax

50 Council Directive (EU) 2016/1164.

51 Council Directive (EU) 2018/822.

authorities on cross-border schemes that include at least one of the risk indicators ('hallmarks') laid down by law.

Following a proposal by the Commission in October 2016, the Member States adopted a Directive on tax dispute resolution mechanisms[52] in October 2017. This instrument lays down rules for resolving disputes more swiftly and efficiently between Member States that arise from the interpretation and application of tax treaties on the elimination of double taxation for citizens and businesses. The Directive creates an obligation to resolve the dispute within a set period of time and delivers an important innovation in that it offers guarantees for the rights of the taxpayer to trigger several stages of the dispute resolution procedure(s).

In October 2016, the Commission re-launched the Common Consolidated Corporate Tax Base (CCCTB) by adopting two proposals that can be implemented in two stages[53]. Member States would as a first step implement the Common Corporate Tax Base (CCTB) and as a second step the Common Consolidated Corporate Tax Base (CCCTB). Both proposals are currently being negotiated in Council. The CCTB proposal includes provisions related to an Allowance for Growth and Investment (AGI), aiming at redressing the current debt bias in taxation. The AGI will give companies equivalent tax benefits for equity as they receive for debt, creating a more neutral and investment-friendly tax environment. Tackling this issue is one of the goals of the Capital Markets Union, since the debt bias in taxation incentivises under-capitalisation, which can make companies more fragile and de-stabilise the economy.

Considerable progress has been made in the area of administrative cooperation in the EU. In 2016, financial institutions initiated customer due diligence on their account holders in compliance with the national measures implementing Directive 2014/107/EU on the mandatory automatic exchange of information in the field of taxation. The purpose is to collect information to be exchanged in accordance with the OECD's Standard for Automatic Exchange of Financial Account Information. The first automatic exchanges of information between tax administrations of the Member States took place in September 2017 and Austria joined the systematic exchanges in September 2018. This closer cooperation will allow tax administrations in the EU to ensure that taxpayers in each Member State comply with their national tax obligations for accounts held in other Member States. Improved tax compliance rules, in particular the self-certification procedures for tax residence included in the due diligence to be applied by financial institutions under the Directive, may help address the concerns of some Member States about applying withholding tax relief and refund procedures.

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52 Council Directive (EU) 2017/1852.

53 For more details, see: http://europa.eu/rapid/press-release_IP-16-3471_en.htm.

The existing savings taxation agreements between the EU and five non-EU European countries[54] (the Principality of Andorra, the Principality of Liechtenstein, the Principality of Monaco, the Republic of San Marino and the Swiss Confederation) have been updated to take into account the automatic exchange of financial account information based on the aforementioned OECD global standard. Two revised agreements (Liechtenstein and San Marino) entered into force on 1 January 2016 and the first automatic exchanges took place in September 2017. The three other revised agreements, including with the Swiss Confederation, entered into force on 1 January 2017 and the first exchanges took place in September 2018.

Against the background of the Capital Markets Union, the Commission is also taking action to encourage Member States to simplify withholding tax relief procedures for compliant tax payers (see Section 4.2.2 for more details), and encourage best tax practices in promoting venture capital[55] and business angel[56] investment in start-ups and innovative companies. The 2017 study on tax incentives for venture capital and business angels[57] found that taxation plays a role in supporting or hampering venture capital and business angel investment. The way in which tax incentives are designed could help lower the risk (upside and downside) of investments in SMEs and start-ups. The study observed 47 tax incentives designed to promote venture capital and business angel investment in the 36 countries sampled.

Taxation is one of the policy areas monitored by the European semester, the EU's annual cycle of economic policy coordination. The main taxation priorities of the 2019 European semester cycle are to stimulate productive investment, support employment, improve tax compliance and promote social fairness. In 2018, the Commission provided country-specific recommendations in the area of taxation to 12 Member States.

4.7 Macroprudential measures

The financial crisis highlighted the need for system-wide oversight and macroprudential measures. Macroprudential policy has been developed as a new EU policy area with the aim of limiting systemic risk using primarily prudential measures that aim to address vulnerabilities that go beyond the scale of individual institutions.

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54 https://ec.europa.eu/taxation_customs/individuals/personal-taxation/taxation-savings-income/2004-ec-agreements_en

55 Venture capital is financing that investors provide to start-up companies and small businesses with long-term growth potential.

56 A business angel is a private individual, often of high net worth and usually with business experience, who directly invests part of his or her personal assets in new and growing private businesses.

57 https://ec.europa.eu/taxation_customs/sites/taxation/files/final_report_2017_taxud_venture-capital_business-angels.pdf

Macroprudential measures are closely related to capital movements. Capital movements may be a source of systemic risks or may interact with macroprudential measures. Macroprudential measures may at times aim to limit excessive capital movements that would offset the original purpose of the policy. Reciprocation measures for example aim to prevent macroprudential measures in a country to address an overheating housing market being rendered ineffective by offsetting increases in foreign bank operations and/or cross-border lending into that country.

The 2013 Capital Requirements Directive[58] and Capital Requirements Regulation[59] provide for a number of instruments for macroprudential use in the banking sector. Some instruments, like the countercyclical capital buffer (CCyB) and the buffer for global systemically important institutions (G-SIIs) are mandatory. Others, like the buffer for other systemically important institutions (O-SIIs), are not mandatory, although the identification of O-SIIs is mandatory. The EU macroprudential toolbox also encompasses other instruments whose application is discretional: the systemic risk buffer (SRB), measures under Articles 124 and 164 CRR, which can address vulnerabilities related to the real estate sector, and national measures under Article 458 CRR, which can only be used in case no other measure has been able to address emerging national systemic risks.

Given that macroprudential risks may be national or may affect more countries at the same time while the policy measures are national in nature, the framework aims to provide Member States with the necessary national flexibility to act. At the same time, it aims to provide appropriate safeguards to ensure that the single market and the free flow of capital are not unduly affected. These safeguards come in the form of EU coordination or authorisation requirements prior to the activation of selected measures. They also encompass a reciprocation framework (mutual recognition) to avoid cross-border leakages and circumvention of measures.

Several Member States have supplemented the macroprudential toolset for the banking sector in EU law with macroprudential instruments in national law. Most of these national instruments relate to mortgage transactions, such as caps on the loan-to-value ratio, loan-to-income ratio, debt-to-income ratio, debt-service-to-income ratio and maturity limits.

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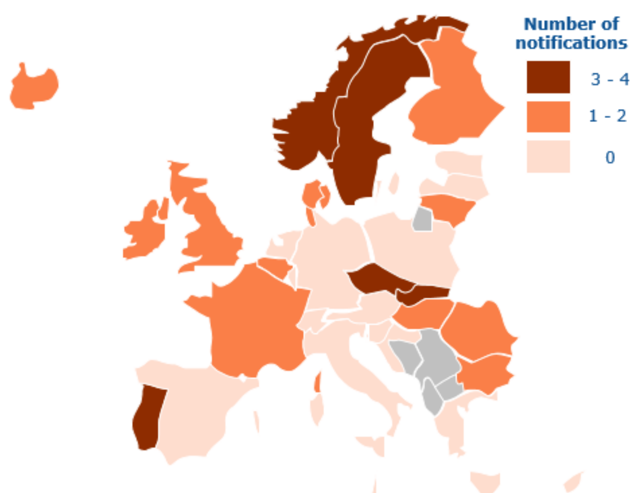
[58] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338).

[59] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

Figure 1: Macroprudential measures of economic significance activated in 2018 by EEA Member States



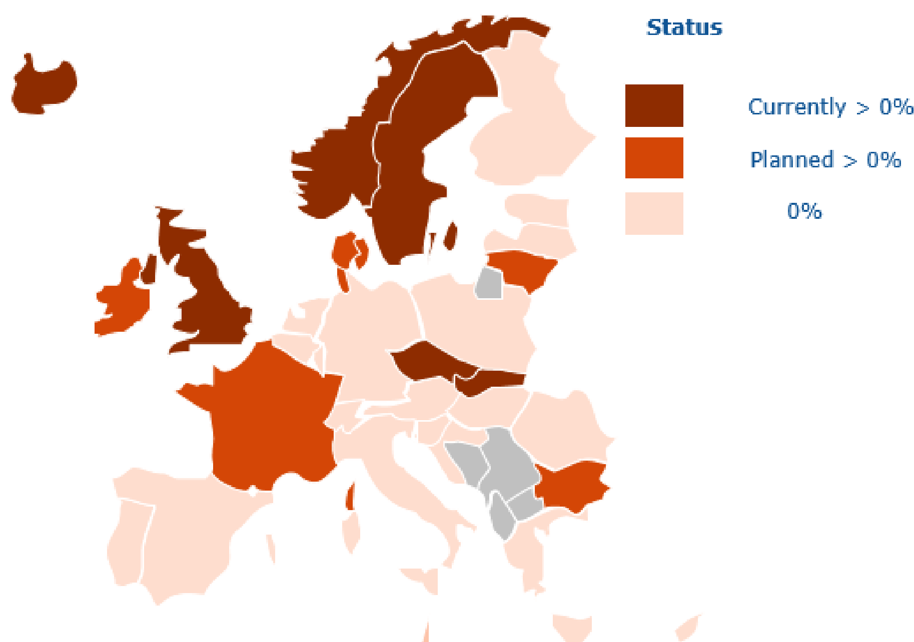
Source: ESRB. European Commission calculations (up to September 2018).

Note: The figure only takes into account notified measures that are of economic significance. Measures of a more procedural or administrative nature, such as setting the countercyclical capital buffer rate at 0 %, are not taken into consideration. Other measures that have to be notified periodically, like the yearly identification of O-SIIs and the CCyB buffer rate, are not reported if they merely serve to confirm the measures already notified. Reciprocation measures are also not regarded as being measures of economic significance.

Notified macro-prudential measures mainly aim to address three types of risks: aggregate credit growth, the systemic importance of financial institutions and the risks stemming from the real estate sector. Figure 1 provides an overview of the number of measures of economic significance per Member State, notified so far in 2018. These measures have been of a tightening nature.

First, the activation of the countercyclical capital buffer (CCyB) is noteworthy. To date, four Member States have set a non-zero CCyB rate (Czech Republic (1 %), Slovakia (1.25 %), Sweden (2 %) and the United Kingdom (0.5 %). These Member States have also announced further increases in CCyB rates. Furthermore, in 2018, Bulgaria, Denmark, France, Ireland, and Lithuania all announced the setting of a non-zero CCyB rate. Figure 2 summarises the activation of the CCyB.

Figure 2: Activation of the countercyclical capital buffer in 2018 by EEA Member State



Source: ESRB. European Commission calculations (up to September 2018).
Note: Czechia has had a 1 % CCyB since July 2018, which is scheduled to increase to 1.25 % from January 2019. Slovakia has had a 1.25 % CCyB since August 2018, which is scheduled to increase to 1.5 % from August 2019. Sweden has had a 2 % CCyB since March 2017, which is scheduled to increase to 2.5 % from September 2019. The United Kingdom has had a 0.5 % CCyB since June 2018, which is scheduled to increase to 1 % from November 2018. Bulgaria has announced an increase of the CCyB from 0 % to 0.5 % from September 2019. Denmark has announced an increase of the CCyB from 0 % to 0.5 % from March 2019, and to 1 % from September 2019. France has announced an increase of the CCyB from 0 % to 0.25 % from July 2019. Ireland has announced an increase of the CCyB from 0 % to 1 % from July 2019. Lithuania has announced an increase of the CCyB from 0 % to 0.5 % from December 2018, and to 1 % from June 2019. In the EEA, Iceland has had a CCyB of 1.25 % since November 2017, which is scheduled to increase to 1.75 % from June 2019, and Norway has had a CCyB of 2 % since December 2017.

Second, around 200 G-SIIs and O-SIIs have been identified in the EU. The additional capital buffer requirements for such institutions vary from 0 % to 2 % (subject to phasing-in). Decisions taken in 2018 have broadly confirmed the results of the previous years in terms of banks identified as G-SIIs and O-SIIs and in terms of calibration of the buffer requirements.

Third, by September 2018 22 Member States had activated measures to address vulnerabilities stemming from the real estate sector (cut-off date September 2018). Compared to 2017, one more Member State introduced borrower-based measures based on national law (from 17 to 18). In 2018, five Member States adopted new or additional borrower-based measures or tightened measures already in place. Borrower-based measures appear to be relatively effective. In practice, borrower-based measures reduce vulnerabilities on the balance sheets of both banks and households, even if they mainly apply to new mortgage loans. Capital-based measures seem to have had a more indirect, limited effect on cyclical adjustments and the cost of loans.

In addition to the above mentioned three types of measures used, the systemic risk buffer is currently used in 13 Member States for a wide range of purposes and two Member States (Finland and Romania) activated a systemic risk buffer for the first time in 2018. Three Member States (Belgium, France and Sweden) also notified draft national measures under Article 458 CRR in 2018. In each case, after giving due consideration to European Banking Authority (EBA) and European Systemic Risk Board (ESRB) opinions the Commission decided not to propose that the Council adopt an implementing act to reject the draft national measures.

Overall, the use of macroprudential measures by the Member States has so far not given rise to major issues in relation to the free movement of capital. This is because the macroprudential toolset is carefully designed to balance the need to address risks with that of preserving the single market. To that end, a number of safeguards exist to avoid unintended consequences. However, the Commission services, the ESRB and the EBA continuously monitor the use of macroprudential measures and their compatibility with the free movement of capital.

4.8 Anti-money laundering and countering the financing of terrorism

4.8.1 Anti-money laundering proposal

On 30 May 2018 a new set of anti-money laundering (AML) provisions were adopted, as Directive (EU) 2018/843[60]. The Member States must transpose this Directive by 10 January 2020. It sets out a series of measures to better counter the financing of terrorism and to ensure increased transparency of financial transactions. In particular, it includes rules to enhance the powers of EU Financial Intelligence Units and to facilitate transparency on beneficial owners of companies and trust, as well as ensure that all Member States set up centralised national bank and payment account registers or central data retrieval systems.

On 12 September 2018, the Commission issued a legislative proposal to further strengthen the AML supervisory framework. The proposal seeks to concentrate anti-money laundering powers related to the financial sector that are currently spread across the three European Supervisory Authorities with the European Banking Authority (EBA). It also proposes to strengthen the EBA's existing mandate to ensure that all relevant authorities effectively and consistently supervise the risks of money-laundering and that they cooperate and share information.

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[60] Directive (EU) 2018/843 of the European Parliament and of the Council of 30 May 2018 amending Directive (EU) 2015/849 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, and amending Directives 2009/138/EC and 2013/36/EU (Text with EEA relevance): https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018L0843

4.8.2 High-risk countries

Under Directive (EU) 2015/849, the Commission is mandated to adopt a delegated act setting out the list of high-risk third countries presenting strategic deficiencies in their anti-money laundering/countering the financing of terrorism (AML/CFT) regimes. The Commission adopted a first Delegated Regulation on 14 July 2016 listing 11 jurisdictions in line with the assessment also made by the Financial Action Task Force (FATF) – the international standard setter in the field. The Commission successively amended this list in order to reflect the latest available information.

In 2018, the Commission confirmed that it would work towards an autonomous assessment methodology to identify jurisdictions presenting strategic deficiencies in tackling money laundering and terrorist financing. On 22 June 2018, the dedicated methodology was issued, with the aim of supporting an objective, fair and transparent listing process[61]. This methodology provides for the main milestones, the assessment criteria and follow-up process.

On 13 February 2019, the Commission adopted a first delegated act based on the new methodology[62].

5 OTHER IMPORTANT CHALLENGES REQUIRING REGULAR MONITORING

5.1 Capital controls in Greece and Iceland

Capital controls are one of the most severe exceptions to the principle of free movement of capital. However, they are necessary to prevent disorderly outflows from causing a financial and economic meltdown. The restrictions imposed in Cyprus until April 2015 and those still in force in Greece and Iceland are recent examples of necessary restrictions on the free movement of capital within the EU/EEA.

5.1.1 Capital controls in Greece

Capital controls have been in force in Greece since 28 June 2015. At the time, the Commission found that the temporary restrictions imposed by the Greek authorities were justified because of the need to preserve the stability of the financial and banking system in Greece.

The Greek authorities adopted a roadmap in May 2017 on the gradual relaxation of capital controls with a view to abolishing them, while at the same time safeguarding financial and macroeconomic stability. The roadmap is a non-binding document that outlines the strategic considerations envisaged by the competent authorities.

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[61] https://ec.europa.eu/info/files/methodology-high-risk-third-countries_en

[62] https://ec.europa.eu/info/files/commission-delegated-regulation-c-2019-1326-supplementing-directive-eu-2015-849-european-parliament-and-council-identifying-high-risk-third-countries-strategic-deficiencies_en

The conclusion of the third review in August 2018 enabled the capital controls implemented in 2015 to be relaxed further. In October 2018, the new regulations introduced the following changes:

- cash withdrawals from credit institutions operating in Greece are permitted without limitation, including withdrawals using credit and prepaid cards issued by credit institutions operating in Greece;

- cash withdrawals are allowed from credit institutions abroad, including withdrawals using credit and prepaid cards issued by credit institutions operating in Greece, up to 5 000 EUR per customer ID;

- modification of the existing provision regarding the transport of cash when travelling abroad. In particular, the permitted limit per traveller was increased from 3 000 EUR to 10 000 EUR;

- allowing the branches of credit institutions to process transactions of higher amounts. In particular, bank branches can process transfers of funds abroad for businesses of up to 100 000 EUR per day per customer (former limit was 40 000 EUR per day per customer), following the submission of the relevant documentation by the customer. Credit institutions remain obliged to report details on these transactions to the Committee for the Approval of Bank Transactions (BTAC) on a weekly basis.

The relaxation steps were taken in accordance with the roadmap of 2017. The Commission welcomes the progress made and will continue to monitor the situation closely, given the implications for competition and the overall functioning of the Greek economy.

5.1.2 Capital controls in Iceland

Article 40 of the EEA Agreement establishes the principle of free movement of capital in the EEA. However, Article 43 expressly permits a contracting party to take 'protective measures' if there are disturbances in the functioning of its capital market, or if it is having difficulties with its balance of payments. Capital controls were introduced in November 2008, after Iceland was struck by an unusually severe banking crisis in October 2008.

Since then, the Commission has been monitoring the situation and discussing the best way forward with the Icelandic authorities and the European Free Trade Area Surveillance Authority. The Icelandic authorities aim to remove restrictions on the free movement of capital in the EEA while safeguarding Iceland's financial and economic stability.

After several rounds of relaxation measures adopted in the years leading up to 2017, on 14 March 2017, Iceland granted full exemptions from nearly all restrictions. Overall, the

remaining capital controls include some minor controls, for example to prevent carry trade[63].

In general, households and businesses are no longer subject to the restrictions that the Icelandic Foreign Exchange Act imposed on foreign exchange transactions, foreign investment, hedging and lending activity in Iceland. The requirement that residents repatriate foreign currency has also been lifted. Foreign investments by pension funds, collective investment funds (UCITS) and cross-border transactions with Icelandic króna have been authorised. Foreign financial undertakings have been authorised to transfer króna and financial instruments issued in domestic currency to and from Iceland.

The status of króna-denominated assets subject to special restrictions – offshore króna assets – remains unchanged. An agreement was reached in 2017 with some owners of offshore Icelandic króna, whereby they sold approximately ISK 90 billion to the Central Bank of Iceland at ISK 137.5 per EUR. Remaining offshore króna assets amount to 88 billion kr, i.e. 3.2 % of Icelandic GDP.

In November 2018, the Icelandic authorities notified the Commission of further steps taken to relax capital controls. Rules on special reserve requirements for new foreign currency inflows were amended, decreasing the special reserve requirement from 40 % to 20 %. Other provisions, for example on the special reserve base, interest rates on capital flow accounts and the holding period, remained unchanged.

The Commission welcomes the progress made by the Icelandic Government in removing capital controls without threatening the country's economic and financial stability. In particular, it welcomes the steps taken in 2017 to lift capital controls on individuals, companies and pension funds.

5.2 Lending in foreign currencies

In the years before the financial crisis, banks in several Member States issued substantial numbers of foreign-currency (mostly CHF) loans to private households, largely due to the more favourable LIBOR interest rates at that time. However, following the global financial crisis and unfavourable exchange rate movements, a large number of those loans became non-performing, as many borrowers could no longer pay back the significantly increased monthly instalments. Many consumers and consumer organisations challenged the validity of certain clauses contained in foreign-currency loans as unfair and not compliant with EU consumer protection law.

Over recent years, the CJEU has developed a substantive body of case-law on the level of protection and the nature of the information to be provided to consumers who are offered

[63] A carry trade is a strategy in which an investor borrows money at a low interest rate in order to invest in an asset that is likely to provide a higher return. This strategy is very common in the foreign exchange market.

foreign currency loans by their banks. Whether these protection standards were met or whether the currency clauses have to be regarded as unfair because consumers were not sufficiently informed about the potentially significant economic consequences of the currency risk has yet to be established by the competent national courts.

The 2014 Mortgage Credit Directive (MCD) now contains specific provisions that address the risks associated with foreign-currency loans. However, the directive only applies to recent credit agreements signed after 21 March 2016.

In parallel, some Member States have adopted or are planning to adopt regulatory measures targeting pre-crisis and pre-MCD foreign-currency retail loans. The Commission is closely monitoring these developments to ensure that any such measures comply with EU law. National measures that restrict the fundamental single market freedoms are acceptable only if they are duly justified by public interest objectives and if they are both suitable and do not go beyond what is necessary to attain these objectives (principle of proportionality).

When assessing a national measure, the Commission takes into account its scope, its consequences for borrowers and foreign investors, its potential impact on financial stability, evidence proving the need for regulatory steps, and compliance with the general principles of EU law such as the principle of legal certainty.

Whenever the Commission has doubts about the compliance of a national measure with EU law, it seeks to engage in a dialogue with the Member State concerned. This is done in order to find a solution that fully ensures compliance with EU consumer protection rights, but also takes into account financial stability and the general principles of EU law. In cases where such a dialogue with the Member States is not successful, the Commission may take appropriate legal action.

5.3 Investments in real estate and agricultural land

Within the meaning of Article 63 TFEU, capital movements include cross-border transactions between residents and non-residents. According to the explanatory notes of the Annex to Directive 88/361/EEC, in the context of investment in real estate these transactions include acquisitions, rights of usufruct, easements and building rights. It is established case-law that the right to acquire, use or dispose of immovable property on the territory of another Member State, which is the corollary of freedom of establishment, generates capital movements when it is exercised[64].

The national laws regulating the abovementioned capital movements, when applied to cross-border situations, must respect EU law, in particular the principle of free movement of capital. The free movement of capital rules allow Member States to impose restrictions on the Treaty freedom, provided these restrictions pursue an objective in the public

[64] Judgement of 25 January 2007, *Festersen*, C-370/05, EU:C:2007:59, paragraph 23

interest, are proportionate and non-discriminatory. The restrictions may differ from one Member State to another. The Commission is assessing the national provisions with a cross-border impact on capital movements on a case-by-case basis.

On the acquisition of agricultural land, Member States are allowed to maintain, during a transition period, derogations from the free movement of capital rules as provided for in their Accession Treaties. Croatia is the only country for which the transition period is still ongoing – the expiry date is 1 July 2020, with the possibility of a 3-year extension. The transitional derogations granted to Bulgaria, Romania, Hungary, Slovakia, Latvia and Lithuania under their respective Accession Treaties expired in 2014, and for Poland in 2016.

Following the expiry of the transitional derogations, these countries adopted new laws regulating acquisitions of agricultural land. The new land laws generally pursue policy objectives such as preserving farming on agricultural land, supporting agricultural communities and preventing land speculation, which may justify restrictions from the Treaty freedom. Nevertheless, concerns arose regarding the compatibility of certain provisions of five new land laws with EU law, in particular in relation to the principle of proportionality. As a result, infringement procedures were started in 2015 against Bulgaria, Hungary, Lithuania, Slovakia and Latvia. In May 2016, the Commission requested that these countries take the necessary measures to eliminate those restrictions on the acquisition of agricultural land from their land laws and thus bring their national laws into line with EU law.

On 12 October 2017, the Commission adopted an Interpretative Communication on the Acquisition of Farmland[65]. The Communication responded to the European Parliament's call for the Commission to explain its policy and provide guidance for Member States on how to regulate farmland markets in line with EU law.

The adoption of the Communication generated considerable interest. The response to the Communication was generally positive. The Commission presented and discussed it with the Member States at a workshop in Brussels as well as in bilateral meetings with the Ministries of Agriculture in Bratislava, Sofia and Warsaw at their request. In addition, the Commission was invited to present the Communication to the Croatian Parliament and to stakeholders, in particular to the European farmers' association Copa Cogeca and the European Landowners Organisation (ELO), which particularly welcomed the legal clarifications regarding restrictions on the acquisition of land[66]. The Commission will continue to engage with the Member States and stakeholders constructively on this topic.

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[65] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.C_.2017.350.01.0005.01.ENG&toc=OJ:C:2017:350:FULL

[66] https://www.europeanlandowners.org/images/CS_Magazines/CS_171_GB.pdf

6 GLOBAL DEVELOPMENTS IN CAPITAL MOVEMENTS/PAYMENTS AND THE EU

A series of different issues affect the free movement of capital beyond the borders of the EU. First, the legal framework under which cross-border capital movements are organised is complex. It includes bilateral agreements with a specific investment and capital movement dimension that are concluded both at EU and Member State level. It also comprises the multi-party OECD Codes of Liberalisation of Capital Movements and Current Invisible Operations[67]. These are legally binding for the currently 23 EU Member States that adhere to the codes as OECD members.

In addition, certain measures such as international law enforcement (particularly on anti-money laundering) and international sanctions are directly linked to how freely capital moves globally.

This report is not exhaustive. As a result, it does not cover unilateral measures taken by non-EU countries that affect the free movement of capital, many of which are currently in force or have recently been adopted. Such measures include screening mechanisms, the prohibition of foreign investment in certain sectors, and a series of intermediate steps such as joint venture obligations and foreign equity caps[68].

6.1 EU investment policy — non-EU countries

6.1.1 Free trade agreements and stand-alone investment agreements

Following the entry into force of the Lisbon Treaty, which gave the EU exclusive competence for FDI (Article 207 TFEU), the Commission engaged in an ambitious negotiation agenda that covers investment liberalisation and investment protection as well as investment dispute settlement in free trade agreements or stand-alone investment agreements.

The investment protection provisions typically cover a number of standards of treatment to be afforded to investors of one party and their investments in the territory of another party: non-discrimination, fair and equitable treatment, prohibition of expropriation without compensation and free transfer of funds, as well as the possibility for dispute settlement between investors and states. At the same time, some of these provisions have raised concerns in the past about how they might interfere with the right of states to regulate. Against this background, the Commission adopted a reform-based approach, which entails modern and innovative provisions to ensure a balance between investors' rights and states' right to regulate on legitimate public policy objectives. The

[67] http://www.oecd.org/daf/inv/investment-policy/codes.htm

[68] For additional information on measures adopted by non-EU countries, see http://trade.ec.europa.eu/doclib/docs/2015/march/tradoc_153259.pdf. On screening mechanisms or measures adopted by EU Member States, see section 6.1.3.1.

Commission applies this approach in all its negotiations on investment protection provisions.

The Court's Opinion 2/15 of 16 May 2017 on the competence to conclude a free trade agreement with Singapore[69] has clarified that the EU has exclusive competence with regard to the substantive standards of protection usually included in investment protection agreements to the extent that they apply to foreign direct investment. On the other hand, the competence with regard to portfolio investment and investor-to-State dispute settlement is shared between the EU and the Member States.

On 18 April 2018, the Commission proposed that the Council sign and conclude the EU-Singapore free trade and investment protection agreements as well as the EU-Japan trade agreement (the negotiations with Japan continue on investment protection and investment dispute settlement). The free trade agreement with Japan was signed in July 2018 and approved by the European Parliament in December 2018 (it entered into force in February 2019). Trade and investment agreements with Singapore were signed in October 2018 and approved by the European Parliament in February 2019. On 13 October 2018, the Commission submitted to the Council proposals for the EU-Vietnam free trade and investment protection agreements. Once authorised by the Council, the agreements will be signed and presented to the European Parliament for consent. Once the European Parliament has given its consent, the trade agreements can then be concluded by the Council and enter into force. The investment protection agreements will also require ratification by the Member States according to their respective internal procedures.

The EU and Mexico started the negotiation process for modernising the EU-Mexico Global Agreement in 2016. The last round of negotiations took place in Mexico City from 12 to 16 February 2018. A political agreement was reached on 21 April 2018. The text of the agreement is now subject to legal revision.

On 18 and 21 June 2018, the EU launched negotiations on free trade agreements with Australia and New Zealand respectively. The future agreements will include investment liberalisation. Investor protection and investment dispute settlement are not part of the negotiations.

In 2018, the negotiations continued on trade and investment agreements with Indonesia, as well as on the stand-alone investment agreement with China (three rounds of negotiations per year). The first exchange of market access offers with China took place over the summer. The negotiations on a modernised trade part of the EU-Chile Association Agreement also ran their course, including a chapter on investment liberalisation and protection. The negotiations on a Deep and Comprehensive Free Trade Area (DCFTA) with Tunisia, which started in October 2015, continued in 2018. Lastly,

[69] Opinion of 16 May 2017, C-2/15, EU:C:2017:376

several rounds of negotiations with Mercosur took place in the reporting period, including on the chapter on services and investment liberalisation.

6.1.2 Member State bilateral investment treaties with non-EU countries

The agreements on investment protection negotiated at EU level with various non-EU countries will gradually replace the bilateral investment agreements concluded by Member States with the same countries. For countries where no EU-level negotiations are envisaged, the Commission can authorise Member States to negotiate and conclude bilateral investment treaties subject to a number of conditions. These are set out in Regulation (EU) No 1219/2012 establishing transitional arrangements for bilateral investment agreements between Member States and non-EU countries.

Under the Regulation, the Member States submit notifications of the opening or conclusion of negotiations with non-EU countries on an ongoing basis. The Commission assesses the notified agreements for their compatibility with EU law and consistency with EU investment policy. A comitology procedure is used to authorise them in consultation with the Member States.

6.1.3 Investment screening

The EU has one of the world's most open investment regimes, and collectively the Member States have the fewest restrictions on FDI in the world. This is expressly acknowledged in the OECD FDI Regulatory Restrictiveness Index, which measures statutory restrictions on foreign direct investment in 62 countries worldwide and how they have changed since 1997.

However, in some cases foreign investors might seek to acquire strategic assets allowing them to access, for example, critical technologies, infrastructure or sensitive information in a way that may pose risks to security or public order. In response to such concerns, a number of Member States have introduced so-called investment screening mechanisms. At EU level, the Commission proposed a new legal framework for screening foreign direct investments from non-EU countries. A political agreement was reached on this in November 2018[70].

6.1.3.1 Member States' screening mechanisms

Almost half of the Member States have set up mechanisms to screen investment in order to safeguard public security or public policy interests (Denmark, Germany, Spain, France, Italy, Latvia, Lithuania, Austria, Poland, Portugal, Finland, the United Kingdom and most recently Hungary). Most of these mechanisms apply to both intra-EU/EEA and extra-EU/EEA investors, while others apply to extra-EU/EEA investors only. Some mechanisms determine sectors in which investments are subject to screening, while others are not limited to specific sectors or list sectors for illustrative purposes only. The

[70] http://europa.eu/rapid/press-release_IP-18-6467_en.htm

screening mechanisms provide for thresholds (e.g. acquisition of 25 % of share capital/voting rights or control in a company) to identify the investments to be screened, which normally exclude portfolio investment. They can be triggered by voluntary or mandatory notifications and, under certain conditions, the public authority may initiate a review on its own initiative. Depending on this, the review may take place before the investment is completed (ex-ante) or after the completion of the investment (ex-post).

In the reporting period, the following new developments were observed in national frameworks for investment screening:

- On 2 October 2018, Hungary adopted its screening mechanism, which entered into force on 1 January 2019 and which concerns investors from countries other than the EU, the EEA and Switzerland.

  The screening introduces a prior notification in the case of acquisitions above certain thresholds in the following sectors: manufacture of weapons and ammunition, dual-use goods, military activity, financial institutions, public utilities (electricity, natural gas and water), electronic communication, and information security of the state and municipalities.

- Germany amended its screening procedures in July 2017 and December 2018. As regards the cross-sectoral screening mechanism, the 2017 amendments introduced a mandatory notification requirement for acquisition of companies relating to critical infrastructure such as energy, information technology, communication, transport and traffic, health, water, food, financial and insurance services. The 2018 amendments added media to the indicative list of sectors relevant to public order or security. They also lowered the threshold for screening in those sectors to the acquisition of at least 10 % of voting rights, while in other sectors the threshold of at least 25 % continues to apply. The 2017 amendments extended the scope of the screening mechanism in the defence sector (sector-specific screening mechanism) to companies that produce certain military equipment. The 2018 amendments reduced the threshold for screening under this mechanism to the acquisition of at least 10 % of voting rights. Finally, the 2017 amendments revised the rules of administration of both screening procedures in view of the growing number and the complexity of acquisitions.

- In France, the government presented a draft law to support the growth and transformation of firms (known as the ‘loi PACTE’) which was voted on by the National Assembly on 9 October 2018 and by the Senate on 12 February 2019. The law comprises very diverse measures aimed at improving the business environment by further reducing barriers limiting the creation and growth of firms. Some of these measures are particularly relevant for the free movement of capital:

  - Proposed changes to the issuance of golden shares in strategic sectors (‘actions spécifiques’). Currently the French state holds such shares in a few

firms in a limited number of strategic sectors: defence (Thales and Nexter System) and energy (Engie). The modifications included in the draft 'PACTE' law open up the possibility for the state to issue golden shares independently from selling stakes and extend the number of firms where the state can decide to introduce them, while confirming that such shares have to comply with the EU Treaties.

- Reform of the investment screening mechanism. The draft law extends the sectors where screening would be applicable and allows for *a posteriori* authorisation to regularise investments.
- France also adopted Decree 2018-1057 of 29 November 2018, which entered into force on 1 January 2019, which expands the sectors covered by screening, enlarges the reasons for refusing an authorisation to invest and expressly allows potential investors to enquire in advance if their envisaged investment would be covered by the screening rules.

- Following a public consultation on the green paper in October 2017, in July 2018 the UK Government presented a white paper outlining possible main elements of the future investment-screening regime. The consultation was open until October 2018. The envisaged screening mechanism is premised on voluntary notifications with the possibility to review investments on the Government's own initiative and would apply essentially to the acquisition of significant influence or control over entities or assets. The grounds for review would be limited to national security. The screening would not be limited to specific sectors, but the guidance document would indicate the sectors in which national security concerns are deemed most likely to arise.

6.1.3.2 Proposal for a Regulation on screening foreign direct investments from non-EU countries

The Commission's proposal for a Regulation presented in September 2017[71] provides for three main features.

First, it sets out a framework for Member States' screening of foreign direct investments in the EU. This includes an enabling provision for setting up or amending screening mechanisms in view of the exclusive competence of the EU under Article 207 TFEU. There is, however, no obligation on Member States to set up such a mechanism. Moreover, guidance is provided on factors that the Member States and the Commission should take into account in their assessment of whether security or public order may be affected. To this end, the effects on, for instance, critical infrastructure, technologies and inputs, which are essential for security and the maintenance of public order, may be

[71] Proposal for a Regulation of the European Parliament and of the Council establishing a framework for screening of foreign direct investments into the European Union, COM(2017) 487 final.

examined. It also lays down basic procedural elements to ensure non-discrimination between non-EU countries, transparency and the possibility of adequate redress for decisions adopted under the screening mechanisms.

Second, it sets up a cooperation mechanism between the Member States and the Commission, including the possibility to exchange information on investments in the EU. This could be used in particular for cases where planned or completed FDI in one Member State may affect the security or public order of another.

Third, the Commission may assess foreign direct investments in the EU on the grounds of security or public order if they might affect projects or programmes of EU interest, and may issue a non-binding opinion to the Member State where the investment takes place. The proposed Regulation sets out a non-exhaustive list of factors for identifying such projects or programmes. Projects and programmes in the areas of research (Horizon 2020), space (Galileo and EGNOS), transport, energy and telecommunications could be covered.

The Commission's proposal allows the Member States to adapt to changing circumstances and their specific national context when screening foreign direct investments. It does not oblige the Member States to adopt a screening mechanism, and the Member States also take the final decision in any screening. This EU-level mechanism aims to be proportionate and transparent while minimising the administrative burden on Member State governments and investors.

In the reporting period, good progress was made in the co-decision procedure. The European Parliament and the Council agreed on their respective amendments to the proposal. On that basis, informal interinstitutional negotiations were concluded in November 2018 and the outcome was endorsed by the European Parliament's Committee on International Trade and by the Committee of Permanent Representatives in December 2018. On 14 February 2019, the European Parliament in plenary adopted the proposal. The legislative procedure is expected to be concluded in March 2019.

6.1.4 Free movement of capital and the OECD

In 2018, the OECD's Advisory Task Force on the Codes (ATFC) focused on the review of the Code of Liberalisation of Capital Movements. The main objective of the review was to strengthen the code by ensuring that it remains relevant in an environment that has substantially changed over the past decades. Discussions have centred on measures adopted to preserve financial stability but other issues, including transparency and decision-making rules, were also reviewed.

Following the last round of exchange of views, which was open for any interested non-OECD country and international organisation, the ATFC discussed the specific amendments to be made to the code and the user guide. The final decision on the revision is to be made by the OECD's Investment Committee and Ministerial Council; according to the current schedule the review will be concluded in May 2019. The Commission participated actively in the review and has introduced additional coordination among

Member States to ensure that their positions are consistent, in particular on matters that are covered by a common legal framework in the EU.

In addition to the review, the ATFC has continued to monitor developments in OECD member countries. The ATFC has also served as a forum to discuss emerging issues and policy initiatives relating to cross-border capital movements in non-OECD countries. It has assisted the Investment Committee in assessing the countries that are in the process of adhering to the OECD or to the codes (similar to the assessment of Lithuania, which acceded to the OECD as the 23rd such EU Member State in July 2018). Meanwhile, the organisation has actively contributed to ongoing international discussions about the need to reform the international financial architecture.

In 2018, the OECD also continued its work to advance the implementation of its guidelines on corporate governance of state-owned enterprises (SOEs), which were last updated in 2015. This is being done against the background of SOEs playing a greater role in the global economy. The Commission is taking part in the dialogue launched by the OECD on this issue. This dialogue aims to develop a stronger understanding of how to address growing policy concerns about the internationalisation of SOEs.

6.2 Economic and financial sanctions for non-EU countries

The possibility of applying restrictive economic and financial measures is one of the general exceptions to the free movement of capital and payments in relation to non-EU countries. Pursuant to Article 215 of the TFEU, restrictive economic and financial measures may be taken against non-EU countries, or individuals, groups or non-state entities. Such measures are based on decisions adopted within the framework of the common foreign and security policy.

The most prominent of the EU's existing sanction regimes during the reporting period were those relating to Russia in response to the ongoing destabilisation of Ukraine. These economic sanctions were first introduced on 31 July 2014, in addition to targeted individual restrictive measures like asset freezes against certain individuals and entities. They include bans targeting Russian interests in the financial, oil and defence sectors. The EU's restrictive financial measures aim to cut off strategic state-owned Russian companies from EU financing sources, thus imposing an indirect financial cost on the Russian state.

In March 2015, the European Council linked the lifting of EU sanctions to the implementation of the Minsk peace agreements. The sanctions have been rolled over by a Council decision every half year since their introduction. On 21 December 2018, the Council prolonged them until 31 July 2019.

The most far reaching EU sanctions regime in terms of the complexity of the financial and capital restrictions imposed is the one against North Korea on account of its nuclear proliferation activities. The sanctions prohibit the transfer or clearing of funds to and from North Korea, maintaining any transactions with banks domiciled in North Korea or the opening of branches and subsidiaries of North Korean banks in the EU and of EU

banks in North Korea. They also require enhanced monitoring by Member States of activities of their financial institutions in relation to activities with regard to North Korean banks, and detailed reporting by EU banks on such activities.

7 CONCLUSIONS

In the reporting period, the Commission continued its efforts to promote the free movement of capital and address barriers impeding it. It did so through legislative proposals implementing the Capital Markets Union Action Plan, cooperating with the Member States in promoting best practices at national level and monitoring legal developments with a view to informing enforcement action. The Commission also provided guidance to the Member States through communications on how to regulate farmland markets in line with EU law and how EU law protects EU investors.

While encouraging the free movement of capital, the Commission ensures the appropriate safeguards are in place. This is the purpose of recent initiatives to combat money laundering and the financing of terrorism, and to insure that foreign investments do not pose risks to security or public order. The Commission also keeps track of developments affecting the movement of capital, such as macroprudential measures or capital controls in Greece and Iceland.

The economic backdrop of slowing cross-border investment globally and in the EU and the uncertainty about the near-term global growth outlook only reinforce the need to strengthen the single market by fostering effective free movement of capital. The Commission will continue its careful monitoring of the free movement of capital and follow up the implementation of recent policy initiatives, in particular the proposals still being discussed by the co-legislators.