Brussels, 6.4.2021
SWD(2021) 68 final

COMMISSION STAFF WORKING DOCUMENT

ON THE MOVEMENT OF CAPITAL AND THE FREEDOM OF PAYMENTS

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CONTENTS

1 INTRODUCTION 4

2 TRENDS IN EU CAPITAL FLOWS IN THE GLOBAL CONTEXT, 2019-2020 7

2.1 Global and EU capital flows 7

2.1.1 Impact of COVID-19 on capital flows in emerging markets 7

2.1.2 Capital flows and debt relief negotiations for EMDEs 8

2.2 Foreign direct investment developments 8

2.2.1 Global FDI developments 8

2.2.2 EU FDI developments 9

2.2.3 EU FDI through special purpose entities 10

2.2.4 Mergers and acquisitions 11

2.3 Portfolio investment developments 12

2.3.1 Global portfolio investments 12

2.3.2 Extra-EU portfolio investments 13

2.3.3 Intra-EU portfolio investment flows 14

2.4 Indicators for financial integration: home bias in EU equity and bond markets 15

2.4.1 Financial integration resilience and composition of cross-border capital flows 15

2.4.2 Resilience of financial integration: debt versus equity instruments 17

2.4.3 Resilience of financial integration: FDI versus portfolio investment 18

2.4.4 Home bias in portfolio investments 18

3 LEGAL ASPECTS 21

3.1 Legal framework 21

3.2 Monitoring 23

3.2.1 Investments in real estate and agricultural land 23

3.2.2 Capital controls 24

3.3 Infringement proceedings 24

4 MAIN DEVELOPMENTS 25

4.1 Response to the coronavirus outbreak 25

4.1.1 Recovery plan for Europe 25

4.1.2 Banking package and release of the prudential buffers 27

4.1.3 Capital markets recovery package 28

4.2 Capital markets union 30
4.2.1 CMU action plan 30
4.2.2 Framework for investment protection and facilitation in the EU 31
4.2.3 Withholding tax 32
4.3 Fostering openness, strength and resilience of the EU economic and financial system 33
4.4 Digital finance and payment services in the single market 34
4.4.1 Digital finance 34
4.4.2 Retail payments 35
4.4.3 Cross-border payments in euro 36
4.4.4 Single euro payments area 37
4.5 Direct taxation and free movement of capital 38
4.6 Macroprudential measures 40
4.7 Countering money laundering and the financing of terrorism 44
4.7.1 5th Anti-Money Laundering Directive 45
4.7.2 Action plan for a comprehensive Union policy on preventing money laundering and terrorist financing 45
4.7.3 Report on trusts and similar legal arrangements 46
4.7.4 Other recent legislative developments to strengthen the AML/CFT framework 46
4.7.5 Enhancing the AML/CFT framework 47
5 GLOBAL DEVELOPMENTS 48
5.1 UK withdrawal from the EU 48
5.2 The LIBOR transition 49
5.3 Free-trade agreements and stand-alone investment agreements 49
5.4 Member States' bilateral investment treaties (BITs) with third countries 51
5.5 Free movement of capital and the OECD 52
5.6 Recent development of the IMF Integrated Policy Framework 52
5.7 Investment screening 53
5.8 Economic and financial restrictive measures (sanctions) against third countries 54
6 CONCLUSIONS 56

1 INTRODUCTION

The free movement of capital is an essential feature of the integrated, open and efficient financial markets that businesses and people in the EU enjoy. It is a key element of the single market. This document reports on capital movements and policy initiatives on the free movement of capital in 2019-2020. It will feed into the Economic and Financial Committee's annual discussions on capital movements and the freedom of payments under Article 134 of the Treaty on the Functioning of the European Union (TFEU).

The **first** part of this report reviews global and EU capital flows and related economic developments. The **second** part sets out the legal framework, details recent policy initiatives and important challenges, and reviews global initiatives on the free movement of capital and the freedom of payments.

The **COVID-19 crisis** has had a significant impact on capital flows. The immediate consequences consisted of high exchange rate volatility and sudden stops in capital flows in several emerging and some advanced economies. Portfolio investment (the most volatile component of capital flows) reduced significantly in March-April 2020, before recovering in the second half of 2020. Cross-border direct investment was also strongly impacted, with global foreign direct investment (FDI) declining by more than 50% in the first half of 2020 compared to the second half of 2019[1]. Total (intra and extra-EU) investment into the EU-27 was still negative and more than twice lower on an annual basis in the third quarter of 2020 compared to the end of 2019. While extra-EU27 FDI inflows increased moderately already in the second quarter of 2020, intra-EU27 FDI inflows stalled and turned mildly positive only in the third quarter of 2020.

Decisive policy actions by monetary and fiscal authorities at national, EU and global level mitigated the effects of the pandemic in the short term. Financial fragmentation in the EU has been avoided, partly thanks to successive regulatory reforms over the last decade that have strengthened the resilience of the financial system since the last economic and financial crisis and streamlined the policy response during the ongoing pandemic. Additionally on a positive note, no country, within or outside the EU, had to resort to capital controls on outflows[2]. Instead, the policy response of the most affected emerging market countries focused on foreign exchange market intervention and relaxed rules on capital inflows to support foreign currency liquidity.

The European policy response to the coronavirus outbreak has been swift, decisive and unprecedented. To mitigate the socio-economic impact of the crisis the EU adopted the largest recovery package ever financed through the EU budget amounting to €1.8 trillion. It comprises the EU's long-term budget and the temporary NextGenerationEU instrument designed to boost the recovery. In parallel, monetary policy and banking supervision measures helped the economy to absorb the shock triggered by the pandemic and kept finance flowing towards all economic sectors and actors. In particular, the €1.8 billion pandemic emergency purchase programme (PEPP) of the ECB aimed at lowering borrowing costs, while several banking supervision measures ensured that banks capacity to lend is not endangered by short-term concerns. The unprecedented amount of fiscal

[1] See OECD, *FDI in figures* (October 2020); http://www.oecd.org/investment/investment-policy/FDI-in-Figures-October-2020.pdf

[2] For more information, see *COVID-19 and global capital flows* (OECD, 3 July 2020), a note submitted to the G20 International Financial Architecture working group; http://www.oecd.org/coronavirus/policy-responses/covid-19-and-global-capital-flows-2dc69002/

and monetary policy supports stabilized financial markets and prevented private risk-sharing channels from collapsing, thus reducing the risk of further “sudden stops” to capital flows. It will increase resilience as well as green, digital and sustainable investment to underpin the post pandemic economic recovery.

Outside the EU, to help contain the impact of the coronavirus pandemic the Commission adopted a proposal for a €3 billion macro-financial assistance (MFA) package to help 10 enlargement and neighbouring countries deal with the fallout from the crisis and its impact on their balances of payments[3]. It also supported the G20-Paris Club’s work on a Debt Service Suspension Initiative (DSSI)[4] for some emerging and developing countries, mostly (but not only) in Africa.

However, the more permanent and scarring effects of COVID-19 are likely to weigh on economic prospects and capital flows in the longer term, through their impact on investment and resource reallocation. The EU economy is projected to return to pre-crisis 2019 GDP levels only by mid-2022, despite the expected recovery[5]. Investment, including cross-border direct investment, is declining just when it is most needed. Policy efforts are therefore being made to mitigate the impact of the ongoing recession and to facilitate the post-crisis economic rebound towards more sustainable production and consumption.

The free movement of capital is one of the four fundamental freedoms enshrined in the EU treaties. The second part of this staff working document presents how the Commission — the ‘guardian of the treaties’ — monitors potential barriers arising from Member States’ **non-compliance with EU law** and takes enforcement action if needed. It also sets out recent Commission policy initiatives to support capital movements and payments.

However, there are also **national measures or practices** that may be compatible with EU law, but nevertheless create barriers to the free movement of capital. This can be due to a lack of harmonisation of national rules or structural factors.

The **capital markets union** (CMU) has helped to remove these barriers and, together with the banking union, make the EU more resilient.

The CMU action plan adopted in September 2020 listed 16 targeted measures to make decisive progress towards completing the CMU, its aim being to get money – investments and savings – flowing across the EU so that it can benefit consumers, investors and companies, regardless of where they are located.

Thanks to the **prudential reforms** implemented in the aftermath of the 2008/2009 financial crisis, banks entered the current crisis in relatively good shape and were quickly able to implement the flexibility suggested in the Commission’s Interpretative Communication of 28 April 2020[6], providing the first tangible assistance to those EU citizens and businesses most hard hit by the COVID-19 crisis.

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[3] https://ec.europa.eu/commission/presscorner/detail/en/ip_20_716

[4] https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative

[5] European Commission, *European economic forecast, winter 2021*, Institutional Paper 144.

[6] Commission Interpretative Communication on the application of the accounting and prudential frameworks to facilitate EU bank lending - Supporting businesses and households amid COVID-19,

Direct taxation is essential to generate revenues for public finances, but can also lead distortions, and influence or discourage capital movements, jeopardising the policy goals of financial legislation. The Commission has been active in promoting fair and efficient taxation, making proposals and communicating on business taxation and the reallocation of taxing rights, including at the global level. It has also proactively guided Member States to prevent COVID-19 financial supports going to undertakings linked with non-cooperative jurisdictions for tax purposes.

In relation to the UK withdrawal from the EU, the Trade and Cooperation Agreement preserves the right for the EU to adopt or maintain measures for prudential reasons, including in order to preserve financial stability and the integrity of financial markets. The Agreement does not include any elements pertaining to equivalence frameworks for financial services. These are unilateral decisions of each party and are not subject to negotiation.

Although the free movement of capital is necessary to the single market, it also carries non-negligible **risks**. As recent scandals have shown, uncontrolled flows can conceal money laundering activities and any weakness in the control framework can facilitate significant fraudulent financial transactions. In addition, large capital flows into a specific sector or Member State can generate financial stability risks, because they can inflate the prices of assets, the use of which as collateral can then fuel big increases in debt levels. The resulting vulnerabilities can, in the event of a sudden stop, lead to debt repayment problems, widespread defaults by debtors and problems for creditors.

In the last year, the Commission has continued to consolidate the EU's **anti-money laundering** and countering the financing of terrorism framework, and called for more ambition in its supervision, as a way to protect investments and avoid a harmful 'race to the bottom' in which financial actors exploit differences in Member States' capacity to deliver a high level of supervision.

The free movement of capital is the only fundamental freedom that is extended to **third countries** in the Treaty. The Commission promotes it actively on the global stage to ensure a level playing field. It does so by negotiating investment and free trade agreements and participating in international organizations such as the World Trade Organization (WTO) and the Organisation for Economic Cooperation and Development (OECD).

Financial openness and free movement of capital requires the **screening of those investments** which could affect security or public order. In March 2020, the Commission issued further guidance[7] in this area, complementing the EU screening framework that became fully applicable in October 2020.

COM(2020) 169, https://ec.europa.eu/finance/docs/law/200428-banking-package-communication_en.pdf

[7] Communication from the Commission: Guidance to the Member States concerning foreign direct investment and free movement of capital from third countries, and the protection of Europe's strategic assets, ahead of the application of Regulation (EU) 2019/452 (FDI Screening Regulation), C(2020) 1981, https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf

Finally, the EU may adopt **restrictive measures** (sanctions) in the form of **economic and financial measures** against third-countries, natural or legal persons, groups or non-state entities under its common foreign and security policy (CFSP).

2 TRENDS IN EU CAPITAL FLOWS IN THE GLOBAL CONTEXT, 2019-2020

2.1 Global and EU capital flows[8]

The economic analysis of capital flows in this report covers two distinct periods. The first encompasses 2019 and pre-COVID developments. The second starts at the beginning of 2020 and covers economic developments affected by the outbreak of the pandemic, which gave rise to an unprecedented shock for the global economy and capital flows.

In 2019, before the outbreak of the pandemic, longer-term developments regarding capital flows and financial account balances (the global distribution of surpluses and deficits) broadly followed the trends of the previous 2 years. By contrast, the data for the first half of 2020 point to a substantial reduction in positive balances, especially for the euro area (EA) and Japan, and the return of a large surplus for China, whereas the United States, the United Kingdom and some financial centres[9] continued to post a negative balance.

It is too early to say how long the changes illustrated by the available 2020 data will persist. To a large extent, they reflect the timing of the impact of the pandemic. China was hit before the rest of the world and was able to restore supply almost fully in the second quarter of 2020, when the EU was in lockdown and the USA was introducing a fiscal stimulus.[10]

2.1.1 Impact of COVID-19 on capital flows in emerging markets

One of the immediate effects of the outbreak of COVID-19 was a sudden stop in flows to emerging market economies (EMEs) in the beginning of 2020. In the first quarter of 2020, non-resident portfolio flows in EMEs exhibited the largest ever capital outflows, exceeding the levels in the global financial crisis[11]. This turned out to be temporary and portfolio flows started to recover in May 2020, while inflows into EMEs accelerated at the end of 2020. Given the uncertainty about the spread of the virus, the recovery is still partial and will take long time. In addition, it has been and will remain uneven across emerging and advanced economies. While it seems somewhat faster in Asian countries, given their reliance on manufacturing, it is slower in Latin American and other emerging markets and developing economies (EMDEs) which rely much more on commodity exports, tourism revenues and remittances.

In the face of global dollar liquidity shortages, some EME central banks have intervened in the foreign exchange market to support depreciating currencies, and several established or expanded swap lines. On the positive side, no capital controls have been imposed on outflows. Rather, responses in this area focused on relaxing rules on inflows, easing liquidity and increasing access to foreign funding. For the first time, EME

[8] For more details on the latest developments in capital movements, see "*Analysis of EU capital flows in the global context*" (2020, CEPS study for the European Commission). Interactive charts on capital flows developments with regular data updates are available from the CEPS at: https://www.ceps.eu/eu-capital-flows-in-the-global-context/

[9] e.g. Hong Kong and Singapore.

[10] For more details on the policy measures to tackle the COVID-19 pandemic across the globe see: OECD, "*Tackling coronavirus (COVID-19): contributing to a global effort*".

[11] "*Sudden stop in emerging markets*" (Capital Flows Report, 9 April 2020); https://www.iif.com/Portals/0/Files/content/2IIF2020_April_CFR.pdf
See also *IMF, "Global financial stability report"* (2020).

monetary authorities have resorted to the use of quantitative easing monetary policy instruments to stabilise their economies[12].

2.1.2 Capital flows and debt relief negotiations for EMDEs

The pandemic set off an unprecedented triple shock in EMDEs (especially in Africa) – a health emergency, the significant fall of oil and commodity prices, and capital outflows – which in turn triggered financial turbulence. Because of high debt servicing, half of the EMDEs had been assessed as being 'high risk' or in debt distress already before the crisis[13]. Over the previous decade, they had experienced the largest and fastest surge in debt levels in 50 years. Leaving China aside, most EMDEs' total debt was higher in 2018 than in 2010, and continued to rise in 2019. Gross external debt increased as well as in the first six months of 2020 as borrowers from emerging economies issued more than USD 400 billion of Eurobonds to international investors, up by one-fifth over the same period in 2019.[14]

Since the outbreak of the pandemic, it has been recognised that low-income countries are facing an even more difficult situation. To allow them to concentrate resources on fighting COVID-19, the World Bank and the IMF called for a debt service suspension initiative (DSSI)[15], supporting a time-bound suspension of principal and interest payments for eligible countries that make a formal request for debt relief from their official bilateral creditors. The initiative was endorsed by the G20 Finance Ministers and Central Bank Governors (FMCBGs) in April 2020, and the EU has been strongly supportive[16]. At the G20 Finance Ministers and Central Bank Governors meeting in October 2020 it was agreed to extend the Debt Service Suspension Initiative by at least 6 months until end-June 2021, with the possibility to extend it for another 6 months by the time of the IMF/World Bank Spring Meetings 2021. As a next step, the countries eligible for the DSSI are also eligible to request debt treatment under the Common Framework for debt treatment beyond the Debt Service Suspension Initiative, which was endorsed by the G20 Leaders in November 2020 and extends the Paris Club procedures to non-Paris Club creditors for the first time ever, setting a positive precedent for the foreseeable future.

2.2 Foreign direct investment developments

2.2.1 Global FDI developments

In the first half of 2020, global FDI fell by more than 40% compared to the second half of 2019 (OECD data[17]). The United Nations Conference on Trade and Development (UNCTAD) forecasts an even bigger drop: up to 40% in 2020 and up to 10% more in 2021. If these estimates are correct, global FDI will fall from about USD 1.6 trillion (net

[12] IMF, *External sector report* (October 2020).

[13] https://www.imf.org/external/pubs/ft/fandd/2020/06/pdf/COVID19-and-debt-in-developing-economies-kose.pdf

[14] "*Emerging economies: where is the debt problem?*", D. Lubin, Chatham House (July 2020).

[15] https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative

[16] The implementation of the G20/Paris Club Debt Service Suspension Initiative (DSSI) has progressed well: as of November 2020, 46 out of 77 eligible countries have requested to participate in the initiative. The combined volume of debt service deferral so far is US Dollars 5.7 billion.

[17] https://read.oecd-ilibrary.org/view/?ref=132_132646-g8as4 msdp9&title=Foreign-direct-investment-flows-in-the-time-of-COVID-19

inflows) in 2019 to less than USD 1 trillion (close to 2004 levels)[18]. According to UNCTAD, it will not return to 2019 levels until 2022. In practice, flows will depend very much on how the health crisis develops and on the policies in place to limit contagion. The reinstatement of lockdown measures in autumn 2020 will slow economic activity again and many multinational companies may reassess new projects.

An overview of net **FDI flows by region** during the last decade show that:

- some countries, such as China, Latin American states, the financial centres and (advanced and emerging) deficit countries, are systematically net receivers of FDI;
- others, such as Japan and (until 2018) the EU-28 and the EA countries, are traditionally net senders; and
- the USA and the UK seem to alternate between positive and negative net positions.

The USA is traditionally a net sender of FDI, but has been a net recipient since 2015. The EU-27 made the same switch in 2019, but it remains to be seen whether this is temporary or a lasting change. It was certainly true in the first half of 2020, with EU-27 FDI inflows higher than outflows.

2.2.2 EU FDI developments

In contrast to portfolio investment flows (which rebounded as early as spring 2020, thanks to swift policy action by the monetary authorities), intra-EU FDI inflows continued to fall in the second quarter of 2020. Both intra-EU and extra-EU FDI inflows had already been on a downward path and negative[19] from 2015, before rebounding modestly in 2019. The COVID-19 pandemic interrupted improvements in the former, while the latter continued to rise and turned positive in the first two quarters of 2020. In a climate of greater uncertainty, that increases the likelihood that there may be more acquisitions of companies in financial difficulty or in critical sectors such as healthcare or information technology. The decline of intra and extra-EU FDI after 2016 is likely to be associated with lower flows through special purpose entities (SPEs) in several Member States.

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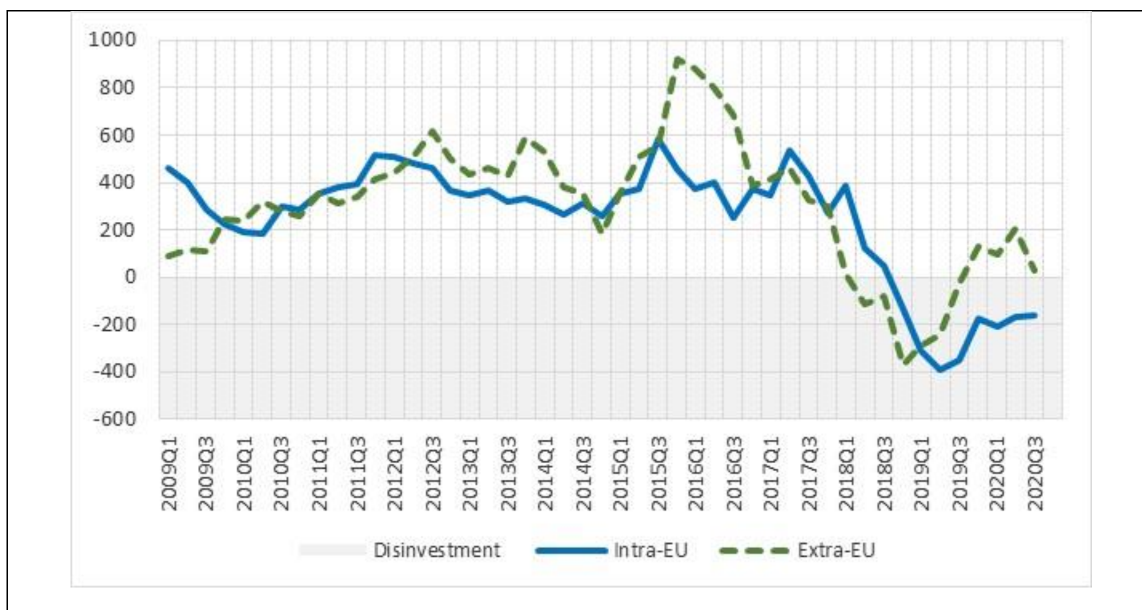
[18] https://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD

[19] Negative values for FDI inflows in the EU indicate disinvestments of previously made FDI.

Figure 1: Intra-EU27 and extra-EU27 FDI, gross flows (4-quarter rolling sums, € billion)



Source: DG FISMA based on Eurostat's balance of payments (BoP) statistics.

Note: Positive (negative) values of FDI liabilities indicate an increase in (or a reversal of previously made) cross-border investments in the direct investment enterprise. Last data observation: Q3 of 2020.

2.2.3 EU FDI through special purpose entities

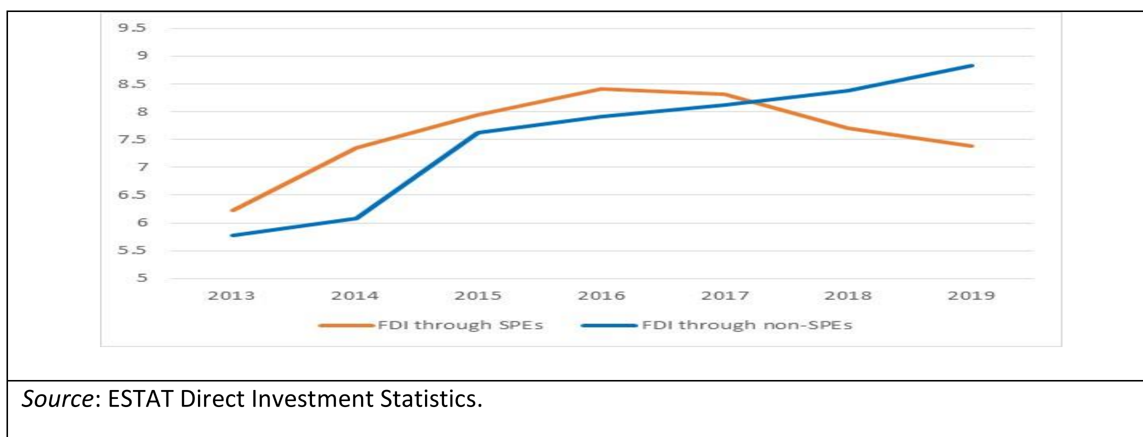
The recent decline in FDI flows has prompted analytical work aimed at identifying the main drivers behind this dynamic. While several explanations have been put forward including recent changes in US legislation affecting cross-border activities of multinational enterprises or other tax considerations, one of the possible reasons behind this dynamic, which is gaining traction, is the slower FDI activity through special purpose entities. FDI is usually considered an important driver of international economic integration, stimulating job creation and boosting productivity through transfers of skills, capital and technology. However, there is a growing consensus that statistics on total FDI substantially overestimate potential productivity gains. Also, the recent declines in FDI may have been driven by lower cross-border flows through special purpose entities (SPEs). Therefore, if this explanation is correct, the negative impact of the lower FDI flows on the European economy and job creation should be less pronounced.

To explore this hypothesis, CEPS (2020) estimated the share of FDI through special purpose entities in the EU based on firm-level data. More specifically, following the approach of Damgaar *et al.* (2019)[20], it estimated the 'real' EU28 FDI positions by netting FDI involving SPEs. It finds that just under half (47.5%) of all inward FDI positions in the EU28 involve SPEs. The result of the firm-level estimation is confirmed by macroeconomic data which shows that in 2019 FDI through SPEs amounted to 46% of the total gross positions of inward FDI in EU-27. Furthermore, the aggregate macroeconomic data leads to the conclusion that indeed, to a large extent, recent declines in inward FDI flows in EU-27 were a result of the slowing down of FDI through SPEs as

[20] Damgaard, N., T. Elkjaer and N. Johannesen, 2019, "*What is real and what is not in the global FDI network?"* (IMF WP/19/274).

the inward FDI position of EU-27, for this type of investment, was 12% lower in 2019 compared to 2016. In the same time the rest of FDI position in EU-27 increased by 11.6% for the same period (Figure 2).

Figure 2: Gross inward FDI positions in EU-27 by type of entity, (€ trillion)



Source: ESTAT Direct Investment Statistics.

2.2.4 Mergers and acquisitions

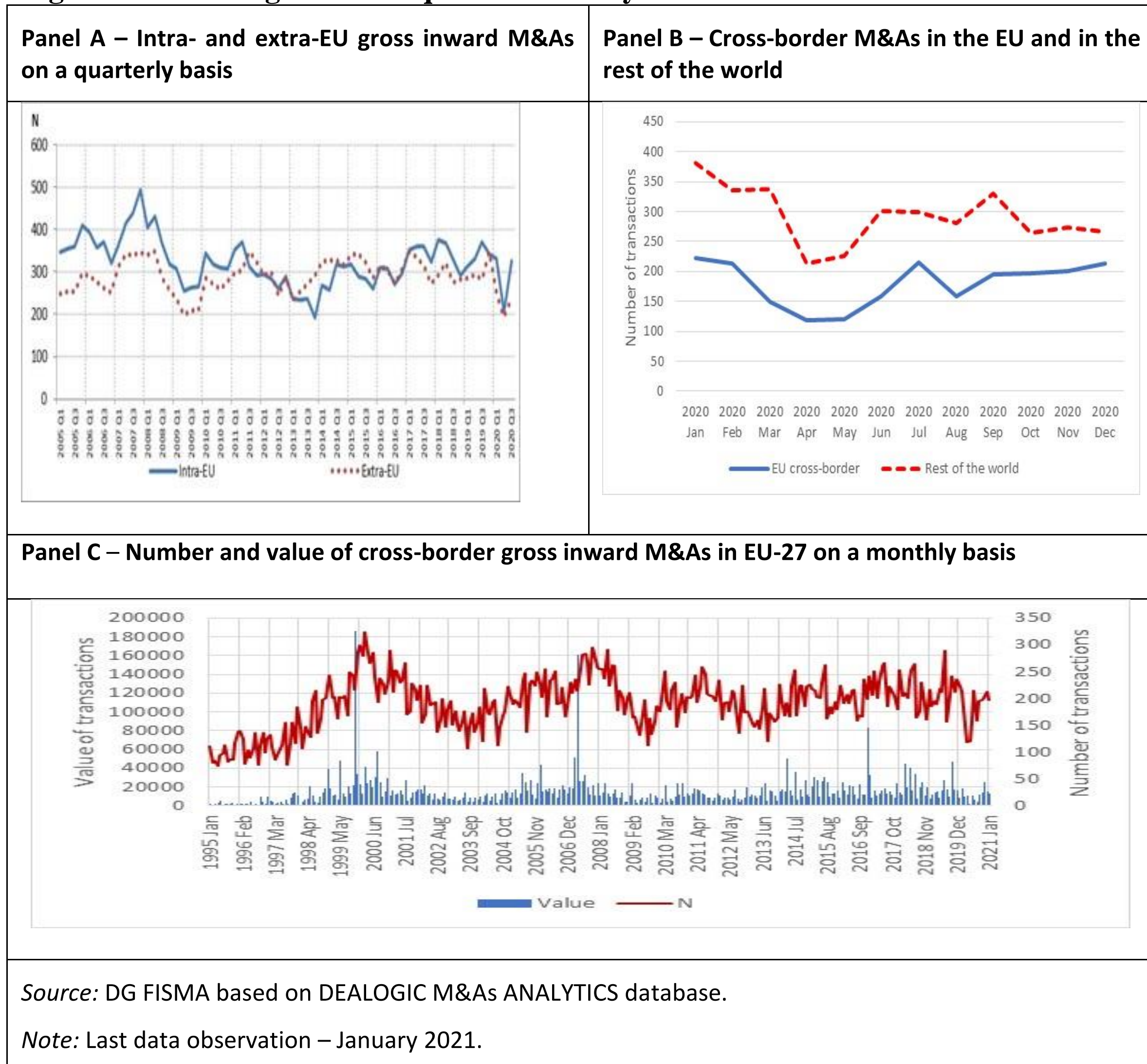
The potential impact of the COVID-19 crisis on mergers and acquisition (M&As) can be twofold:

- the increased uncertainty can lead investors to delay productive investment decisions; and
- the difficult economic environment can facilitate 'easier' acquisitions of European companies in difficulty or in critical sectors.

Also, the difficulties for firms in certain sectors can lead to higher (than in normal times) international disinvestment or foreign investors selling EU companies that they acquired previously.

Against the backdrop of the unfolding COVID 19 crisis the number of gross inward M&As into the EU declined in 2020 compared to the previous year exceeding the record lows of the 2008 crisis (Figure 3). Both the value and the number of cross border inward M&As declined in 2020 by 34% and 18% on an annual basis, respectively. The decline of extra-EU inward M&As was higher than that of intra-EU M&As (by 19% and 52%, respectively, for the value of transactions). International divestment declined as well (by almost 45% for the value of intra-EU divestment and 32% for the value of extra-EU divestment), most likely as foreign sellers were having difficulties to go out of previously made investments. While it is difficult to determine exactly the reason for the lower M&A activity, the timing of the particularly sharp decline coincides with the peak of the COVID 19 crisis with restrictions on travel and activity in February-April 2020 (Panel C of Figure 3). While M&A activity resumed later on in 2020, both the value and the number of transactions remain on a downward trend. When compared with the rest of the world, M&A activity in the EU had a similar slowdown at the beginning of the year with a less pronounced rebound afterwards.

Figure 3: Mergers and acquisition activity in EU-27



Source: DG FISMA based on DEALOGIC M&As ANALYTICS database.

Note: Last data observation – January 2021.

2.3 Portfolio investment developments

Portfolio investments are considered the most volatile component of the financial account, in that they react most rapidly to changes in risk aversion and unexpected events as was the case with the outbreak of COVID-19.

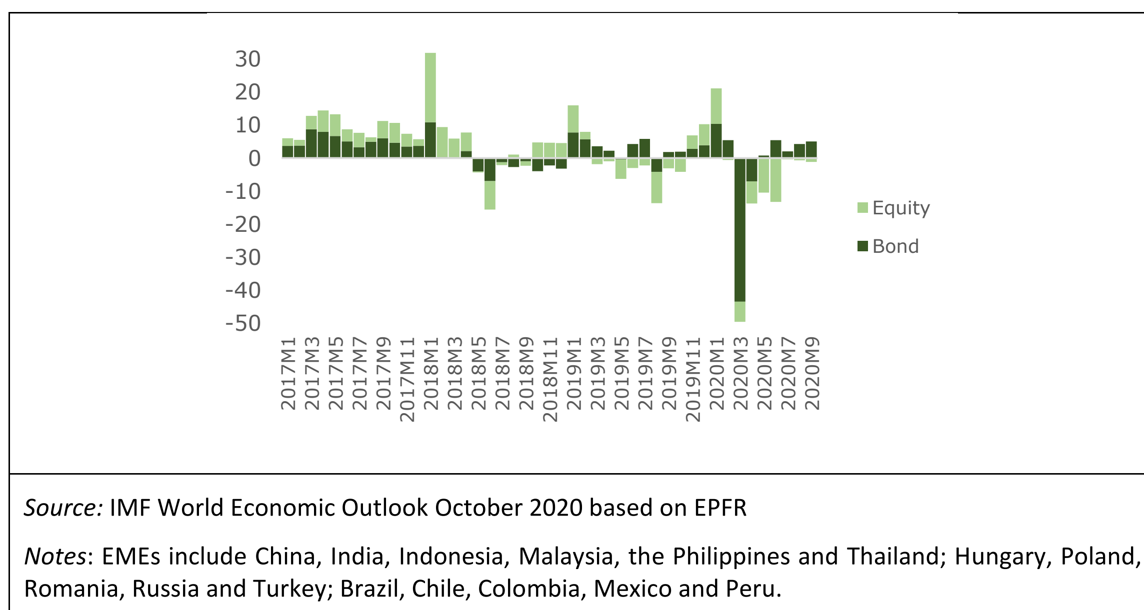
2.3.1 Global portfolio investments

The outbreak of COVID-19 triggered a sudden stop in portfolio investment flows to EMEs. In the first quarter of 2020, non-resident portfolio flows saw the largest outflow ever, exceeding the levels of the global financial crisis (see Figure 4). At the same time, longer-term yields declined from the beginning of the year across advanced economies, indicating a surge in flows to ‘safe havens’.

The sudden stop in portfolio flows to EMEs turned out to be only temporary. A gentle recovery started to materialise in May and continued over the summer. A stronger than expected recovery in China comforted equities. Nonetheless, the recovery in-flows are still partial and appear uneven across countries. In addition, some countries’ bond markets are still far from pre-pandemic levels of activity. While interest rates fell after March, in the autumn the EME bond index in Turkey, South Africa and Mexico was still

more than 200 basis points above January's levels. Protracted uncertainty continues to weigh on the recovery and flows to these countries.

Figure 4: EMEs – net inflows in funds (USD billion)



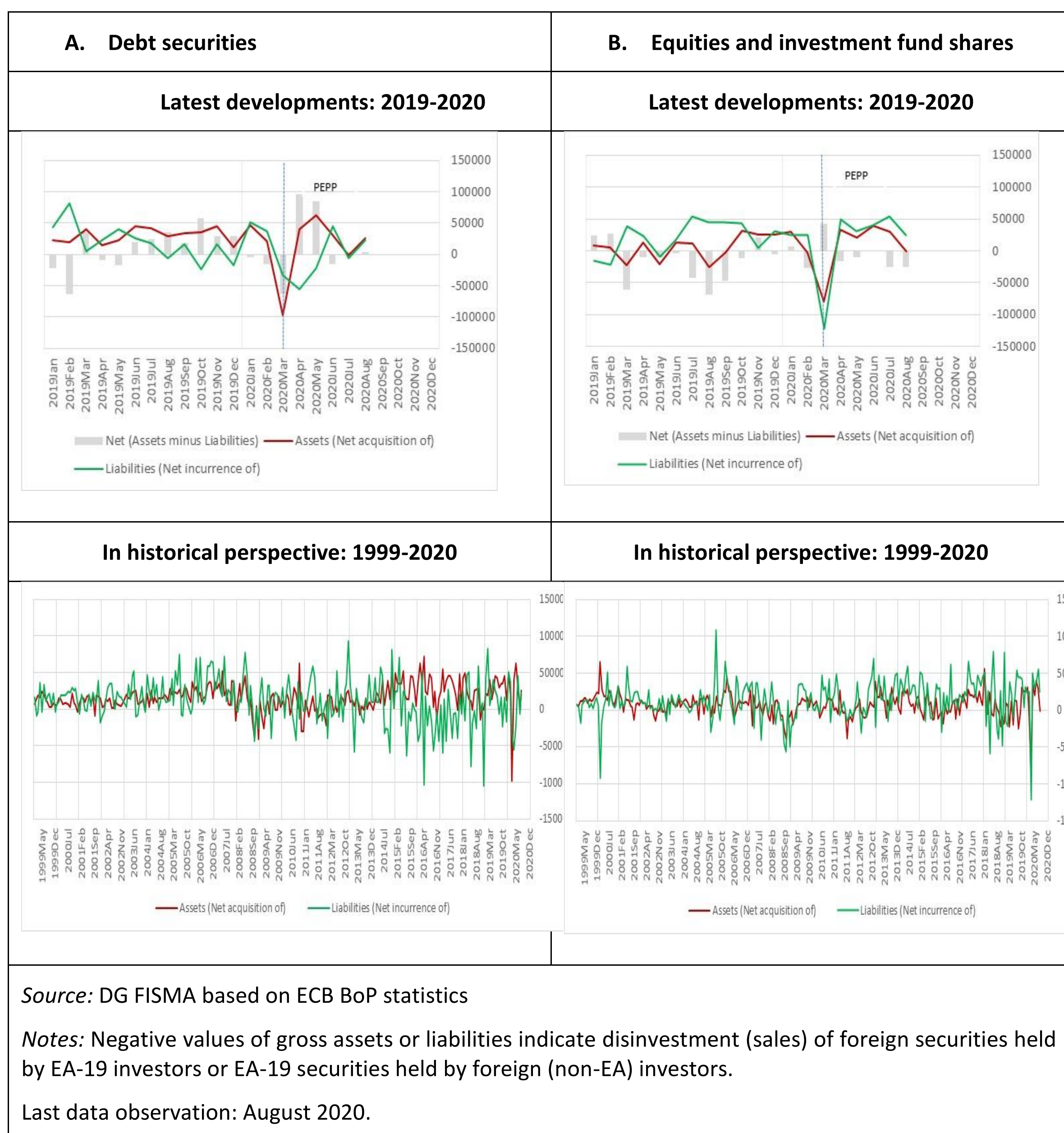
Source: IMF World Economic Outlook October 2020 based on EPFR

Notes: EMEs include China, India, Indonesia, Malaysia, the Philippines and Thailand; Hungary, Poland, Romania, Russia and Turkey; Brazil, Chile, Colombia, Mexico and Peru.

2.3.2 Extra-EU portfolio investments

The impact of the pandemic on EU portfolio investment was unprecedented but short-lived, thanks to the prompt action taken by European and national monetary policy authorities. It can best be seen in monthly data. As a result of increased uncertainty triggered by the outbreak, both EA and non-EA investors were selling their foreign holdings of euro area securities in February-March 2020, as evidenced in monthly balance of payments data (Figure 5). The sell-off affected debt and equities/investment fund shares on a similar scale and affected predominantly mutual fund flows. The launch of the European Central Bank (ECB) pandemic emergency purchase programme in March put a stop to this negative dynamic. As a result, portfolio investment flows in the EA19 rebounded as of April 2020.

Figure 5: Extra-EA debt and equities portfolio investment flows (€ million)



Source: DG FISMA based on ECB BoP statistics

Notes: Negative values of gross assets or liabilities indicate disinvestment (sales) of foreign securities held by EA-19 investors or EA-19 securities held by foreign (non-EA) investors.

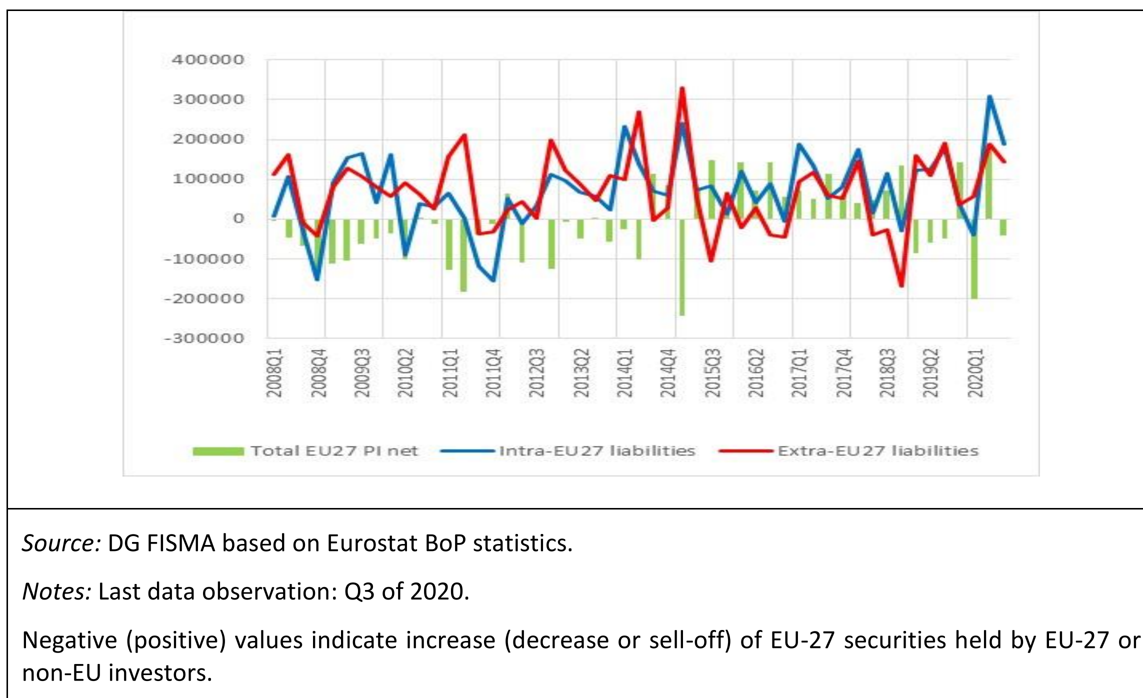
Last data observation: August 2020.

2.3.3 Intra-EU portfolio investment flows

Intra-EU portfolio investment flows were also affected by the pandemic, with portfolio investment liabilities (EU-27 investors' holdings of debt and equity securities issued in other Member States) declining sharply in the first quarter of 2020 and rebounding in the second quarter (see Figure 6).

However, the overall magnitude of the disinvestment in the first quarter was smaller than during the 2008/2009 economic and financial crisis and the 2011-2014 sovereign debt crisis, while the subsequent rebound in the second quarter of 2020 was greater. Intra-EU gross portfolio inflows were more resilient than extra-EU inflows.

Figure 6: Intra-EU27 and extra-EU27 portfolio investment, gross flows (€ million)



Source: DG FISMA based on Eurostat BoP statistics.

Notes: Last data observation: Q3 of 2020.

Negative (positive) values indicate increase (decrease or sell-off) of EU-27 securities held by EU-27 or non-EU investors.

2.4 Indicators for financial integration: home bias in EU equity and bond markets

The free movement of capital is at the core of a well-functioning single market. Observed levels of financial integration depend on market developments and provide evidence of remaining barriers to the free movement of capital. Therefore, as in previous years, this report reviews a number of indicators on financial integration based on external positions and foreign holdings of financial instruments and securities[21].

2.4.1 Financial integration resilience and composition of cross-border capital flows

Financial integration has improved since the 2008/2009 crisis when measured by price-based indicators (returns, interest rates and market prices), while remaining at subdued levels when measured by quantity-based indicators (external positions and claims)[22]. However, as a result (*inter alia*) of regulatory reforms and supporting policy measures, it seems also to have become more resilient. Therefore, the COVID-19 shock has not (based on the two types of indicators) triggered longer-term disruptive financial fragmentation of the scale and proportion of the declines in the composite indicators in the two previous crises[23].

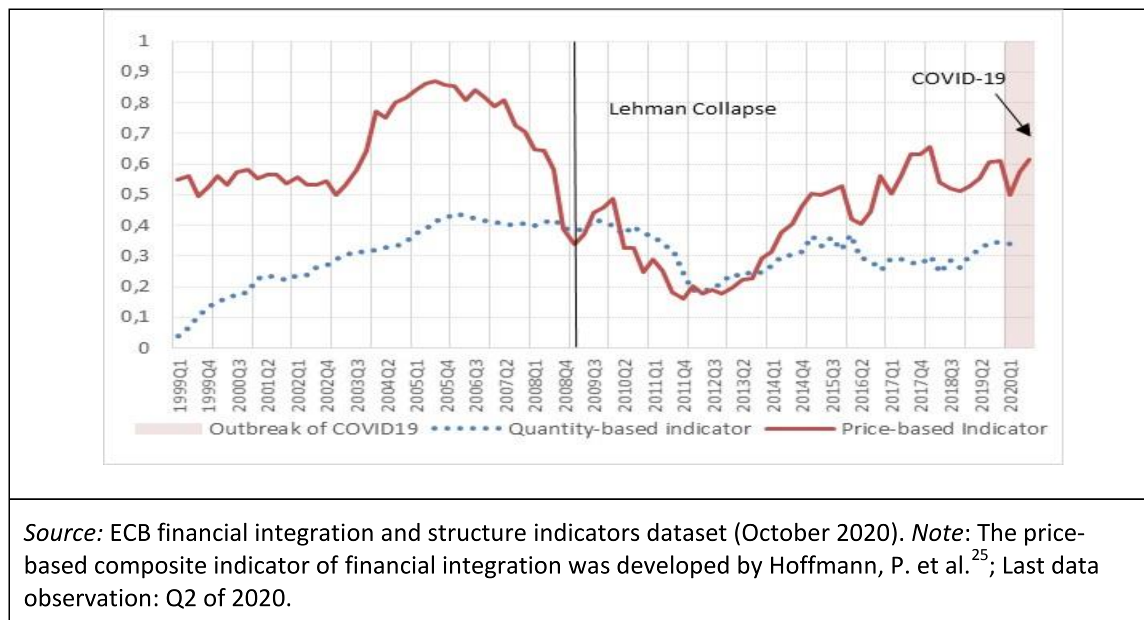
[21] For more details on financial integration, see ECB reports „*Financial integration and structure in the euro area*“, biannually, and the European Financial Integration and Stability (EFSIR) report by the European Commission, forthcoming. Interactive charts with regular data updates are available from the CEPS at: https://www.ceps.eu/eu-capital-flows-in-the-global-context/

[22] ECB 'Financial Integration' report, successive years.

[23] "*European financial integration during the COVID-19 crisis*", Stefano Borgioli et al., ECB Economic Bulletin, Issue 7/2020.

Nevertheless, as a result of the pandemic the ECB's price-based composite indicator[24] dropped sharply in early 2020 before recovering by the end of the second quarter, while recent improvements in the quantity-based composite indicator were put on hold (Figure **7**).

Figure 7: Quantity and price-based composite indicators of financial integration in the EA



Source: ECB financial integration and structure indicators dataset (October 2020). *Note*: The price-based composite indicator of financial integration was developed by Hoffmann, P. et al.[25]; Last data observation: Q2 of 2020.

Furthermore, financial integration and risk sharing (as measured by consumption and output correlations) dropped[26] to record lows in early 2020 and continued to worsen until the second quarter of 2020 (the latest available data point before the publication of this report) (Figure 8). The COVID-19 pandemic crisis is specific with respect to its socio-economic impact in two aspects: (i) it has been relatively synchronized across EU countries, and (ii) the capacity of households to consume a large share of their normal consumption baskets has been limited[27]. Therefore, the traditionally used indicators for risk sharing based on consumption smoothing (and consumption-output correlations) may not be the most appropriate for the current crisis. If instead measures for income smoothing (and income-output correlations) are used, the preliminary assessment based on the available so far quarterly data shows that euro area countries managed to smooth income during the early months of the crisis[28]. Nevertheless, the very high correlation of

[24] Price-based measures of financial integration capture discrepancies in asset prices across countries and sectors, as opposed to quantity-based measures, which are based on cross-border holdings of different asset classes and usually have a lower frequency of observation coupled with significant time lags before publication.

[25] "Financial integration in Europe through the lens of composite indicators", Hoffmann, P., Kremer, M. and Zaharia, S. (2019), ECB Working paper N 2319, 2019.

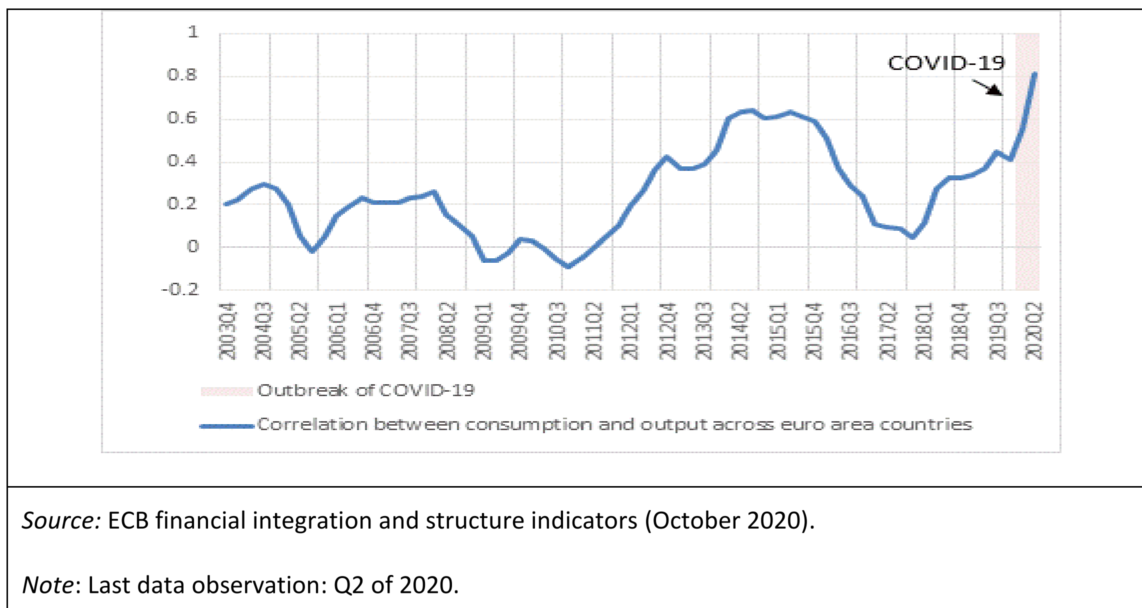
[26] High and statistically significant correlation between consumption and output is considered as a sign of lower financial integration and risk sharing.

[27] Dossche, M and S Zlatanos (2020), "COVID-19 and the increase in household savings: precautionary or forced?", *ECB Economic Bulletin Issue 6*.

[28] Giovannini, A, Horn, C and Mongelli, Fr., "An early view on euro area risk sharing during the COVID-19 crisis, *ECB and VOXeu*, 2021.

consumption and output in the EA after the outbreak of COVID-19 illustrates the potentially detrimental effects that such a shock could have had on the single market and underlines the importance of the EU-level measures for financing the recovery.

Figure 8: Correlation between consumption and output across euro area countries



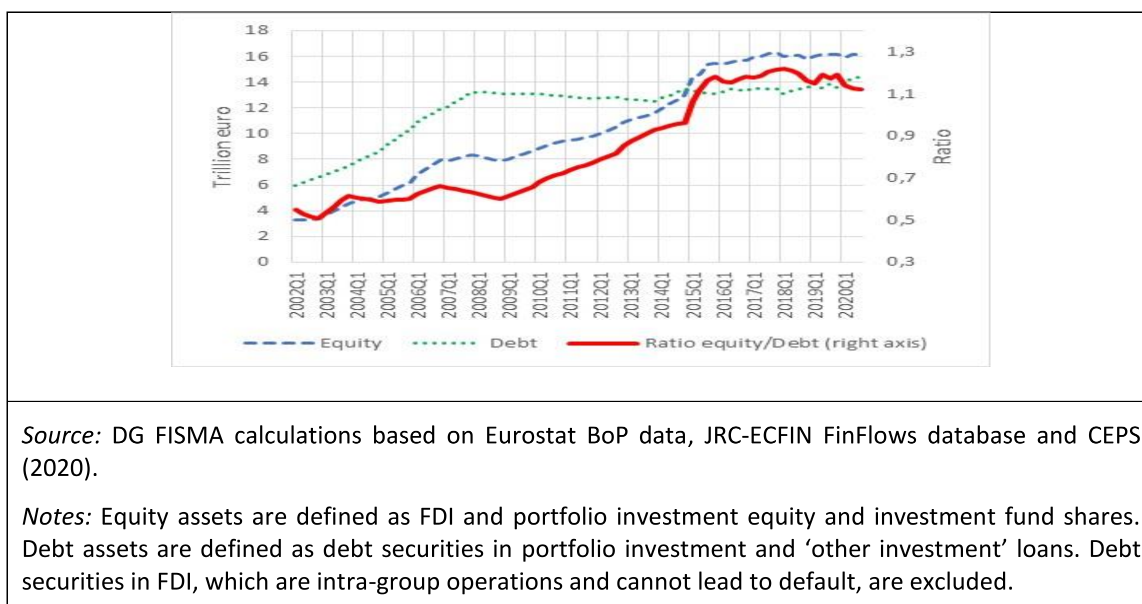
Source: ECB financial integration and structure indicators (October 2020).

Note: Last data observation: Q2 of 2020.

2.4.2 Resilience of financial integration: debt versus equity instruments

The composition of intra-EU foreign claims has changed in recent years, with equity instruments exceeding debt instruments since 2015 (Figure 9). The ratio of equity to debt foreign assets has been increasing since 2005, indicating a substantial improvement in the resilience of EU financial integration. This is also a sign of the greater diversification of EU (cross-border) funding structures. Equity instruments are considered to have more risk-sharing and risk-absorption capacity and can thus improve financial integration resilience.

Figure 9: Intra-EU cross-border holdings of equity and debt instruments, 2005Q1-2020Q2



Source: DG FISMA calculations based on Eurostat BoP data, JRC-ECFIN FinFlows database and CEPS (2020).

Notes: Equity assets are defined as FDI and portfolio investment equity and investment fund shares. Debt assets are defined as debt securities in portfolio investment and 'other investment' loans. Debt securities in FDI, which are intra-group operations and cannot lead to default, are excluded.

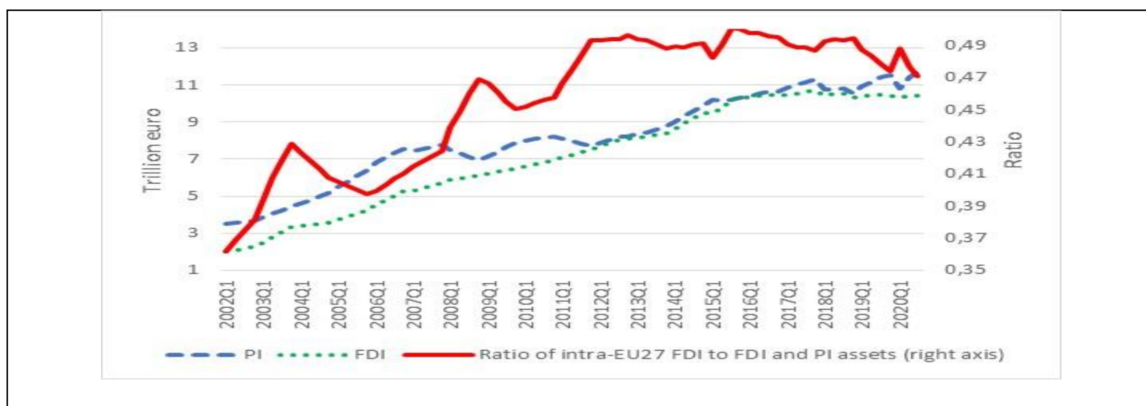
For interactive charts and more frequent updates from CEPS (2020), see: https://www.ceps.eu/eu-capital-flows-in-the-global-context/; Last data observation: Q3 of 2020.

2.4.3 Resilience of financial integration: FDI versus portfolio investment

Another indicator for the resilience of financial integration is the ratio of (total) FDI to the sum of (total) FDI and portfolio investments, measured here in terms of stocks. While FDI is expected to be very stable and resilient to change, portfolio investment is more volatile, as positions can be changed rapidly at a lower cost.

Since 2011, (total) FDI and portfolio investment stocks for the EU-27 have been at almost the same level, although FDI is always smaller (Figure 10). Since late 2018, portfolio investments have picked up, whereas FDI has flattened out, resulting in a fall of the ratio close to 2011 levels and the trough of 2014. In early 2020, the ratio declined further as a result of intra-EU FDI being strongly affected by uncertainty and the COVID-19 crisis, while intra-EU portfolio investment was already rebounding in the second quarter of 2020.

Figure 10: Intra-EU27 FDI and portfolio investment, 2005Q1-2020Q2



Source: DG FISMA calculations based on Eurostat BoP data, the JRC-ECFIN FinFlows database and CEPS (2020).

Note: For interactive charts and more frequent updates from CEPS (2020), see: https://www.ceps.eu/eu-capital-flows-in-the-global-context/; Last data observation: Q3 2020.

2.4.4 Home bias in portfolio investments

As in previous years, we report developments in the home bias in portfolio investment flows (i.e. investors' preference for domestic portfolio investments over foreign assets). Intra-EU home bias can be interpreted as a measure of financial integration among EU countries[29]. Extra-EU or global home bias, on the other hand, measures integration with global markets and is calculated from the proportion of domestic portfolio investments over portfolio investments outside the EU[30].

[29] The lower the intra-EU home bias, the higher will be the share of investment within the EU relative to the share of the domestic market.

[30] For additional information on the methodology, see: Nardo, M., Ndacyayisenga, N., Pericoli, F. and Poncela, P., *JRC.B1 contribution to the SWD on the movement of capital and the freedom of payments* (2018). For more details on the results, see: Nardo M., Ndacyayisenga N and Rosati N., *Monitoring portfolio investment in the EU through the lens of home bias* (forthcoming, 2021).

2.4.4.1 Intra-EU home bias

Figure 11 shows the average propensity of EU investors to invest in other Member States, in comparison with investing domestically. Over the last 10 years, the intra-EU home bias (calculated as the simple average home bias for equity and debt portfolio instruments) increased slightly, from 79.5% in 2009 to 81% in 2013, before improving gradually to 76.5% in 2019 (the lowest level in the observation period). Data for 2020 is not yet available.

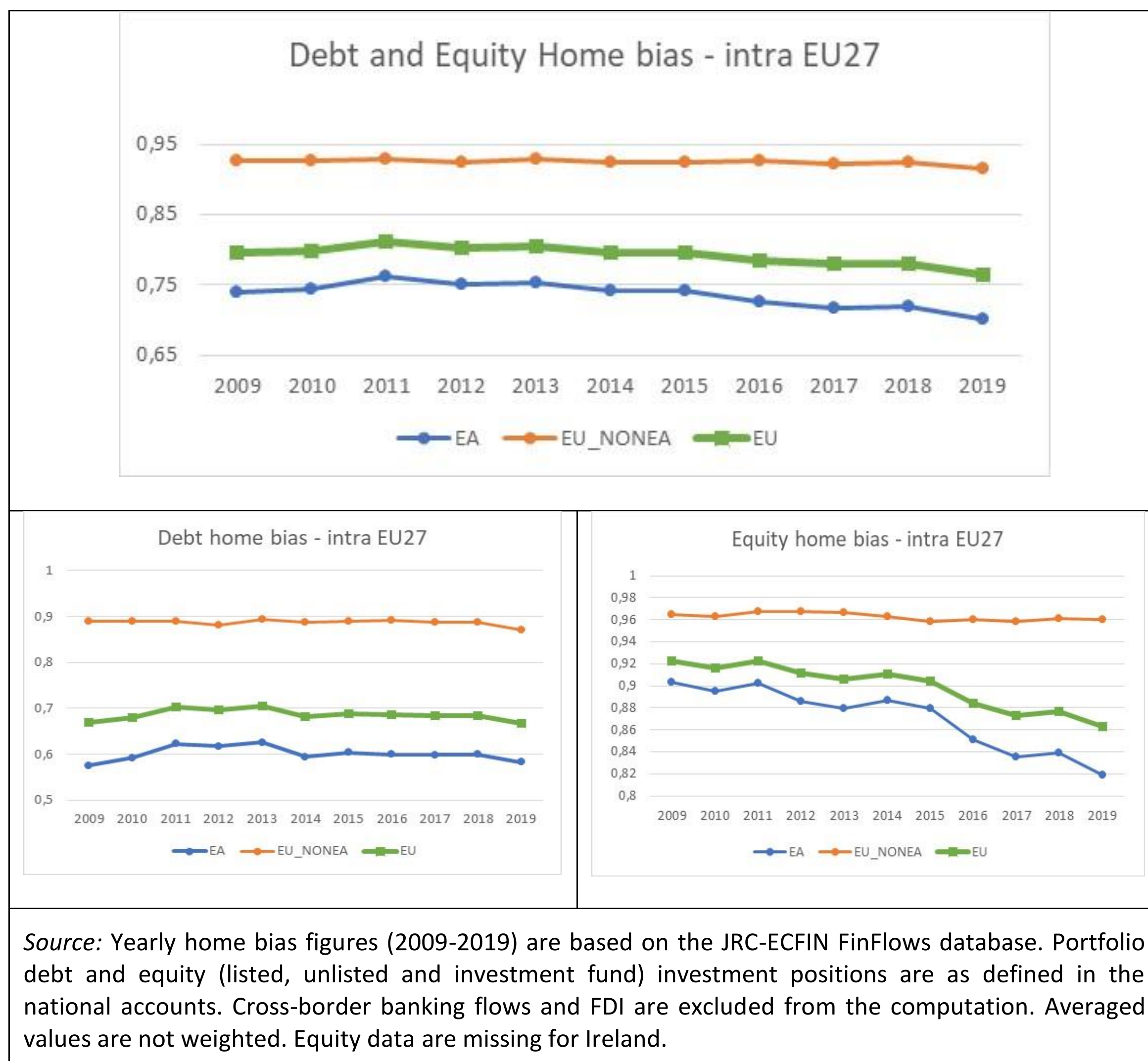
On average, a larger decline is observed in the EA as of 2015. For this group of countries, the home bias reached a value of slightly over 70% in 2019 (down from 71.7% in 2017-2018), which is 21 percentage points (pp) below the level in the non-euro Member States, whose intra-EU home bias stood at 91.5% and had been largely stable since 2009.

Different instruments are undergoing **different trends**: equity investments remain more biased than debt towards domestic holdings, but the debt home bias shows continuous improvement, declining from 91% in 2013 to 86% in 2019.

Few changes are observed for **non-EA Member States**, where the intra-EU debt home bias declined to 87% in 2019, while equity home bias remained almost unchanged at 96-97%.

In contrast, intra-EU equity home bias for **EA countries** dropped from 90.3% in 2009 to 81.9% in 2019. Their intra-EU debt home bias peaked at 63% in 2013 (during the sovereign crisis), stabilised thereafter at 60% until 2018 and dropped to 58% in 2019.

Figure 11: Intra-EU home bias, EU-27 – yearly values for debt and equity (top panel) and yearly averages for debt and equity (bottom panel)



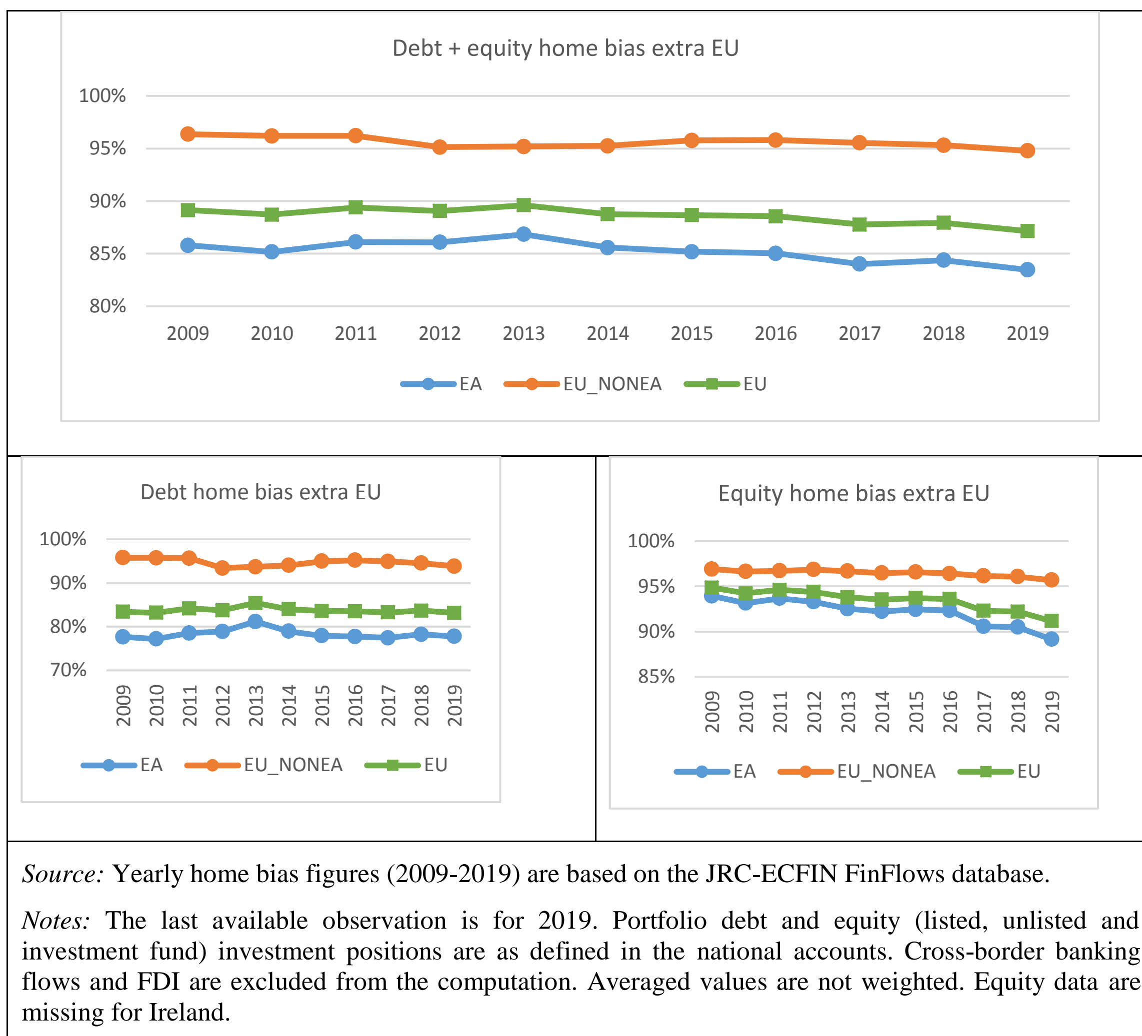
Source: Yearly home bias figures (2009-2019) are based on the JRC-ECFIN FinFlows database. Portfolio debt and equity (listed, unlisted and investment fund) investment positions are as defined in the national accounts. Cross-border banking flows and FDI are excluded from the computation. Averaged values are not weighted. Equity data are missing for Ireland.

2.4.4.2 Extra-EU (or global) home bias

Figure 12 presents the extra-EU home bias, i.e. the degree to which EU investors invest outside the EU rather than domestically. With respect to portfolio investments, EU-27 capital markets are, on average, 10 pp more integrated in the EU than elsewhere.

The extra-EU home bias for Member States was as high as 87.2% in 2019, slightly down from 90% in 2013. This is mainly due to the equity home bias in EA countries, which declined to 91.2% in 2019 from 94.6% in 2011, but remains at very high levels. A slightly downward trend is also observed in the debt market, where the EA countries are again responsible for most of the reduction (from 81.2% in 2013 to 78% in 2019).

Figure 12: Extra-EU home bias – yearly values for debt and equity (top panel) and yearly averages for debt and equity (bottom panel)



Source: Yearly home bias figures (2009-2019) are based on the JRC-ECFIN FinFlows database.

Notes: The last available observation is for 2019. Portfolio debt and equity (listed, unlisted and investment fund) investment positions are as defined in the national accounts. Cross-border banking flows and FDI are excluded from the computation. Averaged values are not weighted. Equity data are missing for Ireland.

3 LEGAL ASPECTS

3.1 Legal framework

The principle of the free movement of capital lies at the heart of the single market and is one of its four fundamental freedoms. While the TFEU does not define the term 'movements of capital', the Court of Justice of the European Union (CJEU) has held that the definitions in the nomenclature annexed to Directive 88/361/EEC[31] can be used to define that term in a non-exhaustive manner[32]. According to the nomenclature, capital movements cover many operations, including:

- FDI, real-estate investments and purchases;
- securities investments (e.g. in shares, bonds, bills and unit trusts);

[31] Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty, OJ L 178, 8.7.1988, p. 5–18.

[32] Judgment C-367/98 *Commission v Portugal* (golden share), EU:C:2002:326, point 37 and the case law referred to.

- 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
- the granting of loans and credits and other operations, including personal capital operations such as dowries, inheritances and legacies, gifts and endowments.

As a rule, all **restrictions on the movement of capital** between Member States and between Member States and third countries are prohibited (Article 63 TFEU). The CJEU has interpreted the term 'restriction' as meaning any measure liable to make cross-border capital movements less attractive.[33]

However, the TFEU allows for capital movements to be restricted 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 provides that the free movement of capital is without prejudice to certain powers of Member States, including:

a) the power to apply relevant provisions of their tax legislation that distinguish between taxpayers who are not in the same situation with regard to 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.

Article 65(1)(b) preserves the Member States' power 'to take measures which are justified on grounds of public policy or public security'. In any case, these restrictions must respect the principle of proportionality. As such, they must be suitable in view of the objective being pursued, must not go beyond what is necessary to achieve that objective and may not be taken if there is a less restrictive alternative.

National measures must comply with other general principles of EU law, such as legal certainty, and fundamental rights. The exceptions provided for in the TFEU must not be invoked to cover arbitrary discrimination or a disguised restriction on the free movement of capital and payments (Article 65(3) TFEU).

Slightly different considerations apply to the movement of capital to and from third countries. The CJEU has stressed that this 'takes place in a different legal context' from that which exists within the EU and that **additional justifications** may be acceptable in this case under the Treaty. Justifications may also be interpreted more broadly[34].

Moreover, any restrictions on certain capital movements (direct investment, real estate, the provision of financial services and the admission of securities to capital markets) that were in place 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 Hungary (31 December 1999) and Croatia (31 December 2002). This means that restrictions on certain capital movements in place before these

[33] See for instance, Judgment C-78/18 - *Commission v Hungary (Transparency of associations)*, EU:C:2020:476, point 53 and the case law referred to.

[34] This interpretation of the case law was confirmed by the judgment of 18 June 2020 in *Commission* v *Hungary*, Case C-78/18, EU:C:2020:476, paragraph 80.

dates that affect nationals of third countries cannot be challenged on the basis of the principle of the free movement of capital under the Treaty.

The Treaty also provides for certain further restrictions that the EU can adopt.

Regarding restrictive measures ('sanctions')[35], the Council may (by means of a decision under Article 29 TEU) interrupt or reduce, in part or completely, economic and financial relations with one or more non-EU country where it deems this is necessary to achieve the objectives of the **common foreign and security policy**. In particular, such restrictive measures may affect exports, imports, transfers of funds, investment and access to the EU's capital markets, and the entry of individuals into the Union. When a decision so disposes, the Council, acting by a qualified majority on a joint proposal from the High Representative of the Union for Foreign Affairs and Security Policy and the Commission adopts the necessary measures in the form of a Council Regulation (Article 215(1) TFEU).

Furthermore, Article 75 TFEU provides for a derogation from the free movement of capital and payments in order to meet objectives in the area of freedom, security and justice in relation to **preventing and combating terrorism**. Such sanctions may include freezing the funds, financial assets or economic gains of natural or legal persons, groups or non-state entities.

Finally, the Council may take temporary safeguard measures in exceptional situations where movements of capital with third countries cause, or threaten to cause, serious difficulties for the operation of **economic and monetary union** (EMU). The general principles of EU law, including the principle of proportionality and respect for fundamental rights, also apply in this context.

3.2 Monitoring

3.2.1 Investments in real estate and agricultural land

The free movement of capital includes investments in real estate classified in the nomenclature annexed to Directive 88/361/EEC[36] on the liberalisation of capital movements. Although the Directive is no longer applicable, the annex may still be used to determine what is covered by the free movement of capital (Article 63 TFEU)[37]. According to the explanatory notes for the Directive, **investment in real estate** covers purchases of buildings and land, the construction of buildings, rights of usufruct, easements and building rights[38]. In addition, the CJEU has clarified that the free movement of capital includes the right to acquire, use or dispose of immovable property[39].

Within the scope of Article 63 TFEU, cross-border investments must not be restricted by national law, unless the restrictions are proportionate to the pursuit of a legitimate

[35] See also section 5.8 'Economic and financial restrictive measures (sanctions) against third countries'.
[36] Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty (OJ L 178, 8.7.1988, p. 5).
[37] CJEU Joint Cases C- 52/16 and C- 113/16, EU:C:2018:157 n 56 (*SEGRO* and *Horváth*).
[38] CJEU C- 235/17, EU:C:2019:432 n 55 — *Commission* v *Hungary*.
[39] CJEU, C-567/07, EU:C:2009:593 n 20 — *Woningstichting Sint Servatius*.

objective and respect fundamental rights[40]. Hence, restrictions may differ from one Member State to another and the Commission assesses them case by case.

In recent years, the Commission has had to look into restrictions on investments in **agricultural land**. Some Member States adopted new laws on the acquisition of agricultural land following the expiry of transition periods during which they were allowed to derogate from the free movement of capital rules[41]. The laws generally pursue policy objectives such as keeping land in agricultural use and preventing excessive land speculation and concentration. However, the Commission has found some of them to be discriminatory and overly restrictive. Since 2015, it has taken legal action against Bulgaria, Hungary, Lithuania, Slovakia and Latvia[42].

On 27 April 2017, the European Parliament adopted a Resolution on the *State of play of farmland concentration in the EU — how to facilitate access to land for farmers*. It called on the Commission to issue guidance for Member States on how to regulate agricultural land markets in line with EU law. The Commission responded by adopting an Interpretative Communication on the acquisition of farmland on 12 October 2017[43].

Subsequently, **Lithuania** and **Slovakia** aligned their land laws with EU legislation, so the Commission was able to close the respective infringement procedures in 2019. Other Member States are making similar changes, but some have yet to take any action.

The Commission continues to engage with the Member States and stakeholders on farmland challenges. At **Croatia**’s request, the Commission has extended to 30 June 2023 the transition period during which the country can derogate from free movement of capital with respect to the acquisition of agricultural land[44]. This is a time-limited exception to the free movement of capital guaranteed in accordance with Croatia’s Treaty of Accession.

3.2.2 Capital controls

Capital controls are one of the most significant exceptions to the principle of free movement of capital. However, they are necessary to prevent disorderly outflows from having a severe financial and economic impact. Such restrictions were imposed in Greece during the sovereign debt crisis of 2015-2018, and in Iceland following the 2008 financial crisis. These are examples of necessary restrictions on the free movement of capital in the EU/EEA.

Greece fully lifted capital controls on 1 September 2019, ending 4 years of restrictions on transfers abroad by companies and individuals. Iceland has maintained minor restrictive provisions[45].

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[40] CJEU C- 235/17, EU:C:2019:432 n 59, 63 — *Commission* v *Hungary*.
[41] 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.
[42] http://europa.eu/rapid/press-release_IP-16-1827_en.htm
[43] https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=OJ:C:2017:350:TOC
[44] Commission Decision (EU) 2020/787 of 16 June 2020 extending the transitional period concerning the acquisition of agricultural land in Croatia (OJ L 192, 17.6.2020, p. 1); https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32020D0787&from=EN
[45] https://www.cb.is/financial-stability/foreign-exchange/capital-controls/

3.3 Infringement proceedings

In the reporting period, the Commission initiated infringement procedures against Finland and the UK for failure to remove the legal effects of their **bilateral investment treaties** (BITs) with other Member States from the legal order. It has been the Commission's longstanding position that BITs between Member States conflict with EU law because they discriminate between EU investors on the basis of nationality. Following the CJEU judgment in *Achmea*[46], all Member States undertook (in their declarations of 15 and 16 January 2019) to remove the legal effects of their intra-EU BITs, from the legal order, in a coordinated manner by means of a plurilateral treaty, unless a bilateral removal of the legal effects, from the legal order, were considered mutually more expedient. A termination agreement was signed on 5 May 2020 and entered into force on 29 August 2020. It provided for the formal and coordinated termination of 124 bilateral investment treaties among Member States, including their so-called sunset clauses, and therefore improved legal certainty. In the termination agreement, the EU Member States concerned confirmed in a formal instrument of international law that intra-EU investor-State arbitration under the intra-EU BITs is precluded, and has been since the accession of both parties to a BIT to the EU.

Austria, Finland, Ireland, Sweden and the UK did not sign this plurilateral treaty[47] . Finland and the UK failed to engage in any discussion with the Member States concerned to proceed with the removal of the legal effects of their intra-EU BITs. On launching infringement proceedings, the Commission therefore urged both Finland and the UK to take all necessary action urgently to remove the intra-EU BITs from their legal order, bearing in mind their incompatibility with EU law. Under the EU-UK Withdrawal Agreement, EU law continued to apply to and in the UK during the transition period and therefore over the course of the reporting period.

Another area in which the Commission has taken action to ensure the free movement of capital is that of **direct taxation**. Although this is primarily an area of national competence, Member States must act in compliance with EU law, including provisions on the free movement of capital. In the reporting period[48], the Commission launched eight infringement proceedings under Article 63 TFEU and Article 40 of the European Economic Area (EEA) Agreement by sending letters of formal notice to Spain (three), Italy, Belgium, Denmark, Hungary and Latvia. It closed 15 proceedings on tax restrictions to the free movement of capital, leaving 30 open cases at the end of 2020.

In 2018, the Court had declared that Belgium failed to fulfil its obligations by retaining provisions under which Belgian taxpayers' rental income from foreign properties was calculated on the basis of actual rental values for properties located in Belgium — themselves based on outdated cadastral values[49]. On 19 November 2019, the Commission brought an action in the Court of Justice against Belgium for failure to implement a previous judgment in the field of the free movement of capital, following an infringement procedure. On 12 November 2020, the Court ordered Belgium to pay to the

[46] Judgment of 6 March 2018, *Slowakische Republik* v *Achmea BV*, Case C-284/16, EU:C:2018:158.

[47] On 5 May 2020, 23 Member States signed an agreement for the termination of intra-EU BITs. The non-signatory Member States are to terminate their intra-EU BITs bilaterally.

[48] 1 January 2019 to 20 October 2020.

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

Commission a lump sum of 2 million euros and a penalty payment of 7 500 euros per day until the compliance with the previous judgment[50].

4 MAIN DEVELOPMENTS

4.1 Response to the coronavirus outbreak

4.1.1 Recovery plan for Europe

The coronavirus pandemic has changed the economic outlook of the EU. Investments and reforms are needed more than ever to mitigate its economic and social impact and ensure a sustainable recovery. This is reflected in the EU's 2021-2027 budget (**multiannual financial framework or MFF**), made up of €1.074 trillion, as well as the temporary recovery instrument, **NextGenerationEU,** of €750 billion (both figures are in 2018 prices), which will be channelled through the EU's 7-year budget, particularly in the years 2021-2023. NextGenerationEU funds will be invested across several programmes, and will be distributed to EU countries and beneficiaries through grants (€390 billion) and loans (€360 billion).

The majority of funds from NextGenerationEU will be spent through the **Recovery and Resilience Facility (RRF)**, offering large-scale financial support for investment and reform efforts. The grant component of the RRF is divided among EU countries according to several allocation criteria. These include Gross Domestic Product (GDP) per capita, unemployment levels, population and the impact of the COVID-19 crisis. As such, RRF financing reflects the needs of Member States' economies and will generate significant capital movements towards the most affected by the crisis. To raise the necessary funds for NextGenerationEU, the Commission will borrow on the capital markets on behalf of the EU, for a total up to €750 billion (in 2018 prices). To preserve its high credit rating and obtain favourable market conditions for borrowing, the Commission will use the headroom of the EU budget[51]. The headroom will serve as a guarantee that the EU will be able to make repayments under any circumstances. The timing, volume and maturity of the bonds issued will depend on the needs of the EU and its Member States. The funds raised will be repaid from future EU budgets or by the Member States concerned, starting after 2027 and by 2058 at the latest. Moreover, to help repayments, new own resources will be introduced to the EU budget to complement Member States' contributions to the EU budget.

Within this framework, EU support will be based on national **recovery and resilience plans (RRPs)**, which should set out a coherent package of reforms and public investment measures (which could also incentivise private investments). The RRPs are to be submitted to the Commission, which will assess them, in particular against the challenges identified in the European Semester (the EU's annual cycle of economic policy coordination), notably the country-specific recommendations adopted by the Council. They are expected to show, among other things, how the investments and reforms will effectively facilitate the Member State's green and digital transitions, which are crucial to achieving a strong, balanced, inclusive and sustainable recovery. The Commission will consider, in particular, whether the investments and reforms contribute to growth

[50] Judgment of 12 November 2020, *Commission* v *Kingdom of Belgium*, Case C-842/19, EU:C:2020:915.

[51] The headroom is the difference between the maximum amount of funds that the EU can request from Member States to cover its financial obligations (own resources ceilings) and the maximum amount of funds that can be spent in a given period (long-term budget payment ceilings).

potential, job creation and economic and social resilience in the Member State in question. Its assessment will be subject to approval by means of a Council implementing decision.

Successful implementation of the RRF will support the green and digital transitions, strengthen the or hasten the recovery and enhance resilience. RRPs could increase their potential by including strategies for attracting significant private investment geared to the same objectives; these could:

- use the EU guidance[52] to companies, investors and policymakers on which economic activities can be considered environmentally sustainable as set out in the EU Taxonomy, the framework to facilitate sustainable investment and to implement the European Green Deal [53]; and
- implement CMU building blocks, ranging from action in broad areas such as local capital market development and financial literacy of the private sector, to more detailed initiatives, e.g. developing specific bond markets or using public funds to share risks from specific investments.

More liquid capital markets would give businesses better access to finance, thus accelerating the impact of public investment and contributing to the recovery of the economic sector.

With respect to free movement of capital, the reform component of the RRPs would ideally address current barriers to cross-border investment.

4.1.2 Banking package and release of the prudential buffers

There was a swift and coordinated policy response to address the needs of the banking sector in the first wave of the COVID-19 pandemic. Supervisors have provided banks with temporary relief, inviting them to use their capital and liquidity buffers, and their operational capacities (built up or increased through prudential reforms implemented in the aftermath of the 2008/2009 financial crisis) to facilitate lending and financial services provision in general. In its 28 April 2020 Interpretative Communication for the banking sector[54], the Commission confirmed the flexibility embedded in the prudential and accounting rules, as highlighted by the EU supervisory authorities and international bodies.

To ensure that banks can continue to play their critical role in supporting households and businesses as an immediate response to the crisis, the Commission also proposed targeted temporary amendments to aspects of the Capital Requirements Regulation[55]. The changes

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[52] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_en

[53] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088

[54] Communication to the European Parliament and the Council, *Commission Interpretative Communication on the application of the accounting and prudential frameworks to facilitate EU bank lending — supporting businesses and households amid COVID-19* (COM(2020) 169, 28.4.2020).

[55] Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards adjustments in response to the COVID-19 pandemic (COM(2020) 310, 28.4.2020). Key measures in the package include:

- transitional arrangements regarding the capital impact of IFRS 9 expected credit loss (ECL) accounting;

were swiftly adopted by co-legislators in an extraordinary effort to ensure their application in time for banks' supervisory reporting for the second quarter of 2020. It is important that banks make use of the adjustments as intended and ensure that credit flows to the real economy where needed.

Recent market observations seem to confirm that these policy responses, coupled with actions taken by the Member States since the start of the pandemic, have so far broadly attained their objectives. EU banks' lending volumes increased in the first half of 2020, supported in particular by the introduction of public guarantee schemes for businesses and the continuation of unconventional monetary policy measures by the ECB. The ECB's most recent lending survey indicates that lending conditions remained broadly favourable in 2020, but started to tighten, a trend which continued in the first quarter of 2021. This was mainly driven by banks' assessment of the risk relating to the general economic outlook and the deteriorating creditworthiness of borrowers affected by the pandemic, whereas banks' capital position remained strong and did not contribute to the tightening. Banks do not expect that regulatory or supervisory action will constrain their capital positions or lead to a decrease in their total assets.

The regulatory reforms implemented after the last financial crisis have made for a stronger and more consolidated rulebook, leaving little room for forum-shopping or a race to the bottom. The swift, unified policy response to the shock caused by the pandemic represents important progress. The fact that it was well-coordinated and consistent with the powerful stimulus provided by the monetary and fiscal measures taken, including at EU level, is further evidence of a fundamental paradigm shift.

In May 2020, as part of the policy response to COVID-19, the Commission launched a dialogue with the EU financial sector and business and consumer representatives to explore how the various actors could participate in efforts to support people and businesses through the crisis and in the subsequent recovery.

Following discussions at two roundtable meetings (28 May and 29 June 2020) with representatives of lenders, insurers, businesses and consumers, the Commission put forward a list of 'best practices' which was then discussed and agreed by the stakeholders . These best practices aim to mitigate the impact of the pandemic on consumers and businesses, and to improve the consistency of relief measures across the EU; more specifically, they involve:

- encouraging lenders to offer credit moratoria and insurers to offer premium payment moratoria to consumers and companies affected by the crisis;
- inviting lenders to ensure that loans to firms to mitigate the impact of the crisis are provided without unnecessary delay and administrative burden, and without excessive fees;
- recommending safer cashless payments while ensuring that cash payments remain available for those who need them; and

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- acceleration of the date of application of a number of CRR II measures (originally scheduled for 28 June 2021), such as:
  - a revised SME supporting factor;
  - an infrastructure supporting factor; and
  - non-deduction of certain software assets from CET1 capital; and
- discretion to apply a temporary prudential filter to certain types of unrealised gains or losses measured at fair value through other comprehensive income.

- inviting insurers to process and pay out legitimate insurance claims as quickly as possible.

The best practices were endorsed on 14 July 2020 by 25 EU-level stakeholder groups. The hope is that relevant financial institutions at national level will follow these best practices on a 'best effort' basis.

4.1.3 Capital markets recovery package

The capital markets recovery package (CMRP) is an integral part of the Commission's post-COVID strategy. It comprises targeted amendments to the regulation of capital markets and banks, with the overarching aim of facilitating their efforts to help the EU economy recover.

The amendments concern:

- the **Prospectus Regulation**[56] –in particular, the 'EU recovery prospectus', a new simplified, short-form prospectus that is easy to produce for issuers, easy to understand for investors and easy to scrutinise for national competent authorities. In order to be an efficient tool that effectively supports the recovery of listed companies, the prospectus is a single document of a limited size focused on essential information that investors need to make informed investment decisions.

  In addition, to provide breathing space for credit institutions supporting the real economy in the recovery, the 'prospectus-free' threshold for their offers of non-equity securities will be raised temporarily (from € 75 million to € 150 million annually). The amendments also make it easier and clearer for intermediaries to contact investors, where required, following the publication of a supplement to a prospectus;

- the Second **Markets in Financial Instruments Directive (MiFID II)**[57] – the package amends the disclosure requirements for investment services targeting professional clients ('business-to-business transactions') to facilitate the execution of such services and allow firms to use their resources more efficiently. The full set of disclosure requirements towards retail clients remains in place. In addition, a very specific amendment to the product governance regime for certain simple products and a phase-out for paper-based information are introduced.

  To address the energy demand shock caused by the pandemic, which was followed by unusual changes in price and volume, amendments were put forward to tackle the inflexibility in the current MiFID II position limit arrangements for derivatives. The position limits for agricultural and food commodities remain untouched;

- the **securitisation framework** – the amendments are designed to facilitate the use of securitisations in the recovery phase, in particular by removing regulatory constraints on securitisations of non-performing exposures, allowing qualifying on-balance sheet ('synthetic') securitisations to benefit from the label of simple,

[56] Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

[57] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

transparent and standardised securitisation and partly preferential capital treatment. The proposed amendments to the Securitisation Regulation[58] and the Capital Requirements Regulation[59] aim to maintain/enhance banks' lending capacities at the current juncture and beyond.

The amendments to the Prospectus Regulation[60] and MiFID II[61] have been adopted by the co-legislators in February 2021. The adoption of the amendments to the Securitisation framework is expected by the end of March.

4.2 Capital markets union

4.2.1 CMU action plan

The Capital Markets Union (CMU) is a market-integration project that supports the delivery of all main EU economic policy objectives. Deep, well-functioning and integrated capital markets are essential to provide the scale of support that the economy needs to recover from the COVID crisis. CMU can help mobilise and channel the enormous investment required to tackle the climate and environmental challenges, and support the digitalisation of EU companies, so that they remain competitive globally. A vibrant, integrated and deep capital market will make the EU more attractive to global investors and foster the inflow of foreign capital. It will boost the weight of euro-denominated securities in global finance, the use of the euro in international transactions and the EU's influence in shaping international rules and standards.

The measures in the new CMU action plan[62] seek to develop the necessary depth for local capital markets, while breaking down the barriers to cross-border integration and increasing interconnectivity. In all areas where barriers to free movement of capital still exist, it puts forward specific actions that commit the Commission to deliver according to a deadline. For example, the action plan:

- sets out practical steps to advance on **withholding tax (WHT)**. In this area, the focus will be on streamlining procedures for withholding tax in cross-border

[58] Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

[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).

[60] Regulation (EU) 2021/337 of the European Parliament and of the Council of 16 February 2021 amending Regulation (EU) 2017/1129 as regards the EU Recovery prospectus and targeted adjustments for financial intermediaries and Directive 2004/109/EC as regards the use of the single electronic reporting format for annual financial reports, to support the recovery from the COVID-19 crisis (OJ L 68, 26.2.2021, p. 1)

[61] Directive (EU) 2021/338 of the European Parliament and of the Council of 16 February 2021 amending Directive 2014/65/EU as regards information requirements, product governance and position limits, and Directives 2013/36/EU and (EU) 2019/878 as regards their application to investment firms, to help the recovery from the COVID-19 crisis (OJ L 68, 26.2.2021, p. 14).

[62] Communication from the Commission to the European parliament, the Council, the European economic and social committee and the Committee of the regions: a Capital Markets Union for people and businesses-new action plan, COM/2020/590 final, https://ec.europa.eu/info/publications/200924-capital-markets-union-action-plan_en

transactions and on lowering tax-related costs for cross-border investors. The Commission will explore ways how to introduce a common, standardised EU-wide system for withholding tax relief at source;

- foresees a legislative or non-legislative initiative for minimum harmonisation or increased convergence[63][64] in targeted areas of non-bank insolvency law such as 1) common definition of insolvency, 2) the conditions for opening insolvency proceedings, 3) the ranking of claims, 4) avoidance actions, 5) the identification and tracing of assets belonging to the insolvency estate. The wide divergence between national insolvency regimes is a long-standing structural barrier to cross-border investment and to CMU as a whole. Divergent and sometimes inefficient national regimes make it difficult for cross-border investors to anticipate the length and outcome of value recovery proceedings in cases of bankruptcy, rendering it difficult to adequately price the risks, in particular for debt instruments.
- aims to make financial and sustainability related company **information** more easily accessible (digitally) for EU and non-EU investors by using a single access point;
- works on an enhanced single rulebook for capital markets and monitor progress on **supervisory convergence**, which is also key post-Brexit. A multi-centre financial architecture needs more harmonisation and convergent supervisory practices to avoid regulatory and supervisory arbitrage. . Recent events, such as the Wirecard and money laundering investigations, have shown the need for greater ambition in this area.

There is no single measure that will complete CMU. All the measures in the new action plan are necessary to gradually build a single market for capital and address any outstanding barriers to free movement of capital. The Commission is working on the implementation of all actions in parallel. Some measures may be important in the short term to help overcome the COVID-19 crisis; others will be instrumental in shaping profound structural change in the medium to long term. Certain actions will be priorities for businesses, others crucial to protect investors, and others still essential for enabling financial institutions to offer cross-border services. The action plan seeks to address all issues and bring the benefits of capital markets to all stakeholders.

4.2.2 Framework for investment protection and facilitation in the EU

The CMU action plan also announces a Commission proposal to strengthen the EU's investment protection and facilitation framework. The termination of all intra-EU BITs[65] following the March 2018 *Achmea* judgment presented an opportunity to revisit the framework. Although EU legislation contains a wide range of provisions protecting investment from unjustified state measures[66], new evidence suggests that a large

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[63] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12592-Insolvency-laws-increasing-convergence-of-national-laws-to-encourage-cross-border-investment

[64] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12592-Insolvency-laws-increasing-convergence-of-national-laws-to-encourage-cross-border-investment/public-consultation

[65] See section 3.3 "Infringement proceedings".

[66] Commission Communication, *Protection of intra-EU investment* (COM(2018) 547 final); https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0547&rid=8

majority[67] of surveyed EU investors do not consider this protection sufficient. This lack of confidence impacts EU cross-border investment, because various aspects of investment protection can be key drivers for investment decisions[68]. Long-term sustainable investments (e.g. in renewables infrastructure) are more likely to be affected by investment protection problems, as they cannot be easily withdrawn. The EU investor community therefore calls for the improvement of both EU substantive rules and the mechanisms for their enforcement[69].

Cross-border investors, including SMEs and individuals investing in various sectors, would benefit from a more stable, more predictable and clearer system of protection from unjustified measures by public authorities. Host states and society at large would benefit indirectly, in particular from the unlocking of long-term investment in policy priorities, such as the European Green Deal, 'Europe fit for the digital age' and an 'economy that works for people'. Expected positive impacts include more infrastructure projects, jobs, innovation, competitiveness, tax income and sustainable economic growth.

4.2.3 Withholding tax

Withholding taxes are an important tool in the fight against tax avoidance. However, Member States and the Commission have long regarded burdensome procedures for recovering tax withheld on portfolio investments as a barrier to a true EU capital market. Such procedures penalise cross-border investments, disrupt financial processes such as clearing and settlement, and increase the cost of cross-border trading, in some cases through double taxation (if the refunds due are not paid according to bilateral taxation treaties).

The 2017 report on national barriers to capital flows[70] and its follow-up, the 2017 joint roadmap[71], identified a series of best practices on WHT recovery proceedings (in addition to relief at source).

The 2017 Code of conduct on WHT[72] is a first non-binding deliverable of the CMU action plan in the area of taxation. It sets out possible actions that Member States can take to address the longstanding problem of long delays and costs in recovering taxes withheld in the country of investment. It calls for voluntary commitments and should be considered as a compilation of best practices to improve the efficiency of WHT procedures. Its main goal is to seek alignment between approaches laid down in the code and Member States' tax administrations' WHT procedures. Several meetings were held

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[67] *Investment protection and facilitation in the EU* (Ecorys study); preliminary findings from targeted survey: only 3 in 10 investors were confident about investment protection in the EU; among business respondents to the Commission's public consultation, over 60% of investor representatives consider the EU legal framework poor or rather poor.

[68] Ecorys study: nearly 6 in 10 see administrative conduct as such. However, 5 in 10 surveyed investors consider that the conduct of public administrations is not transparent, predictable or duly justified. 7 in 10 cross-border investors consider the stability and predictability of the legal framework a key factor for investment decisions, while 4 in 10 are not satisfied with the current situation.

[69] Among business respondents to the Commission's public consultation, 8 in 10 investors think EU investment protection rules should be more specific; none of the business respondents (representing 10 million businesses) consider that enforcement of the rules is adequate. Almost all call for enforcement mechanisms at EU level.

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

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

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

in 2018 and 2019 on the implementation of the code and some progress has been made. However, some outstanding issues remained.

In 2020, in its final report[73], the CMU High-Level Forum recommended that the Commission put forward a legislative proposal to introduce a standardised system for WHT relief at source based on authorised information agents and withholding agents.

In the reporting period, as confirmed in the 2020 tax action plan[74] and CMU action plan[75], the Commission announced that it would be proposing a common, standardised, EU-wide system for WHT relief at source. Subject to a positive impact assessment, options to be considered include legislative and non-legislative intervention, taking into account the OECD's treaty relief and compliance enhancement (TRACE) initiative[76]. New mechanisms will be explored for information exchange and cooperation among tax administrations, and cooperation between them and financial markets supervisory authorities. The objective will be to lower tax compliance costs significantly for cross-border investors and to prevent tax evasion.

4.3 Fostering openness, strength and resilience of the EU economic and financial system

The EU is a large open economy with a globally interconnected financial sector. In recent years, the global economy has become increasingly multipolar, with a number of countries increasingly relying on the strength of their economies to underpin their international influence.

Most recently Brexit has emphasised some vulnerabilities of our financial system arising from dependencies on third countries, including the overreliance on non-EU operators to clear euro-denominated derivatives.

The heavy reliance on the US dollar as a global main reserve currency amplified the US dollar funding squeeze following the Covid-19 outbreak in March last year. A more multipolar global currency regime could mitigate external monetary shocks from third countries and would increase global financial stability.

In order for the EU to continue enjoying the benefits of its openness while limiting associated vulnerabilities, the EU must take action to foster the resilience and strength of its economic and financial system. This effort fits into a broader goal of fostering an open strategic autonomy by affirming EU's economic and financial autonomy, while continuously championing multilateralism and openness. A stronger EMU, an enhanced international role for the euro, resilient financial infrastructures and a more effective and protective sanctions policy are mutually reinforcing elements of a strategy to strengthen the EU's open strategic autonomy in economy and finance.

The Commission kicked off work in this area in 2018 with a Communication, *Towards a stronger international role of the euro*[77], setting out key actions to foster the international

[73] https://ec.europa.eu/info/sites/info/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf
[74] https://ec.europa.eu/taxation_customs/sites/taxation/files/2020_tax_package_tax_action_plan_en.pdf
[75] Action 10; https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM:2020:590:FIN
[76] http://www.oecd.org/ctp/exchange-of-tax-nformation/treatyreliefandcomplianceenhancementtrace.htm
[77] https://ec.europa.eu/commission/sites/beta-political/files/communication_-_towards_a_stronger_international_role_of_the_euro.pdf

role of the single currency. This was accompanied by a Recommendation on the international role of the euro in energy[78] and followed by five sectoral consultations on the role of the euro in foreign exchange markets, in the energy sector, in raw materials markets, in the trade of agriculture and food commodities, and in the transport sector[79].

The Communication on fostering the openness, strength and resilience of Europe's economic and financial system[80], adopted on 19 January 2021, sets out a number of policies to further strengthen the international role of the euro, to better develop EU financial-market infrastructures and to improve their resilience, including against the illegal extra-territorial application of sanctions by third countries, and to increase the effectiveness of EU sanctions. Completing the banking and capital markets unions are fundamental components of the policy to boost the euro's international role, with the latter becoming even more important post-Brexit. The EU bonds to be issued under the Next Generation EU recovery plan will play an important role in further developing and integrating EU capital markets. By increasing the depth and liquidity of highly-rated euro-denominated securities, the Next Generation EU bonds will help make the euro a more attractive reserve currency, thereby increasing the diversification of the reserve currency regime and enhancing global financial stability.

On top of these key building blocks, the Commission will pursue a number of additional, targeted actions to strengthen the international role of the euro. These include reaching out to third-country partners, fostering the use of the euro in the trade in financial instruments as well as in energy (in particular gas and nascent energy markets like hydrogen), promoting the euro as a vehicle for 'green transition', and working with the ECB on the possible introduction of a digital euro.

In addition, the EU has to do more to address vulnerabilities of its financial system and critical financial infrastructure (e.g. stock exchanges, certain banks, central counterparties, central securities depositories). These infrastructures are strategic nodes in the financial system and their international operations make them subject to foreign laws and policies. In this context, work is ongoing with the European Supervisory Authorities, the ECB and with the industry to assess possible technical issues relating to the transfer of financial contracts denominated in euro or other EU currencies cleared outside the EU to central counterparties located in the EU. Work is also under way to assess and remedy the vulnerabilities of EU financial market infrastructures as regards the unlawful extra-territorial application of unilateral sanctions by third countries. In addition, the Commission will explore ways to counter the unlawful extra-territorial application of third-countries' unilateral sanctions in order to secure an uninterrupted flow of capital and financial services with third countries while complying with the EU law and international agreements.

In this context, it is also important for the EU to strengthen the implementation and enforcement of EU sanctions[81]. EU sanctions play a critical role in upholding the EU's

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[78] https://ec.europa.eu/info/publications/recommendation-international-role-euro-field-energy_en

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

[80] Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions: the European economic and financial system: fostering openness, strength and resilience, COM(2021) 32, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021DC0032&qid=1611728656387.

[81] See also section 5.8 below.

values and in projecting its influence internationally. However, implementation is not as uniform across the EU as it ought to be. This creates distortions in the Single Market as EU companies, including EU subsidiaries of foreign companies, can circumvent EU sanctions. This also creates uncertainty among operators. Inconsistent enforcement undermines the efficacy of EU sanctions, and the EU's ability to speak with one voice. A full and uniform implementation of EU sanctions would increase the EU's credibility as a regulatory power and preserve the integrity of and the level playing field of the Single Market.

4.4 Digital finance and payment services in the single market

4.4.1 Digital finance

The future of finance is digital: consumers and businesses increasingly access financial services in digital form, and innovative market participants are deploying new technologies to challenge traditional business models. Digital finance has helped citizens and businesses tackle the unprecedented situation caused by the COVID-19 pandemic.

On 24 September 2020, the Commission adopted a **digital finance package**[82] based on broad public consultations and outreach; it includes:

- a digital finance strategy;
- legislative proposals on crypto-assets and digital resilience; and
- a retail payments strategy for the EU.

The package is intended to promote a competitive EU financial sector that gives users access to innovative financial products, while ensuring financial stability.

The **digital finance strategy** is an opportunity for the EU to relaunch and modernise its economy through digital technologies in the recovery from the COVID crisis, and to move forward as a global digital player. Embracing digital finance and increasing digital financial awareness could unleash EU innovation and allow it to develop new financial products. Digital finance would open up new channels to mobilise funding in support of EU businesses, the Green Deal and the new industrial strategy for Europe. As digital finance accelerates cross-border operations, it also has the potential to enhance financial market integration in the banking union and the CMU, and thereby strengthen EMU. A stronger and more inclusive digital finance sector would allow the EU to improve its open strategic autonomy in financial services and, its capacity to regulate and supervise the financial system to protect financial stability, the final customer (transparency, personal data) and EU values. As part of the package, the Commission proposed a **framework on crypto-assets** to allow for innovation while preserving financial stability and protecting investors. It differentiated between crypto-assets that are already governed by the EU regulatory framework for financial services, and other crypto-assets. While the former remain subject to the applicable EU legislation on financial services, the Commission proposed a new regime for previously unregulated assets as well as a pilot regime for market infrastructures that wish to implement trading and settlement of financial instruments in crypto-asset form (also known as 'tokenised' financial instruments).

[82] https://ec.europa.eu/info/publications/200924-digital-finance-proposals_en

Another part of the package, **'digital operational resilience'**, involves all financial firms ensuring they can withstand all types of ICT-related disruption and threat. Banks, stock exchanges, clearing houses and fintechs have to comply with strict standards to prevent and limit the impact of such incidents. The Commission also proposed an oversight framework for technology companies (such as cloud services) that provide cloud-computing services for financial institutions.

4.4.2 Retail payments

Directive 2007/64/EC on payment services in the internal market[83] established a comprehensive legal framework on retail payments and introduced the concept of payment institutions to bring more competition to a market previously dominated by credit institutions.

The payment market has changed significantly since 2007. Today, many innovative players are operating in the market, which, increases innovation and competition. The market has the potential to become more competitive than ever before, provided new restrictions on competition do not arise or are duly controlled. Up to 2015, new types of payment services were not regulated by the Directive, which was revised and updated to take account of technological developments and introduce stronger security measures. The revised act, Directive (EU) 2015/2366 on payment services in the single market[84], came into force at the beginning of 2018 and is accompanied by a range of delegated acts, the most important of which is Commission Delegated Regulation (EU) 2018/389[85], which became applicable on 14 September 2019.

Under the Delegated Regulation, banks and other account-servicing payment service providers have to apply stricter security measures to their payments. They must also operate communication interfaces that allow providers of new types of payment services to access the data of the account holders in question (subject to their explicit consent). These developments will catalyse innovation in the area of payments and other financial services, leading to the development of new payment and account-related services, and eventually driving the market towards open banking.

4.4.3 Cross-border payments in euro

Regulation (EC) No 924/2009 on cross-border payments[86] requires that fees for cross-border payments in euro within the EU (i.e. payments from one euro Member State to another) be the same as fees for domestic payments in euro (i.e. payments within the

[83] Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC (OJ L 319, 5.12.2007, p. 1).

[84] Directive (EU) 2015/2366 of the European Parliament and of the Council of 25 November 2015 on payment services in the internal market, amending Directives 2002/65/EC, 2009/110/EC and 2013/36/EU and Regulation (EU) No 1093/2010, and repealing Directive 2007/64/EC (OJ L 337, 23.12.2015, p. 35).

[85] 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 (OJ L 69, 13.3.2018, p. 23); https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32018R0389.

[86] Regulation (EC) No 924/2009 of the European Parliament and of the Council of 16 September 2009 on cross-border payments in the Community and repealing Regulation (EC) No 2560/2001 (OJ L 266, 9.10.2009, p. 11).

same Member State). Although covered by the Regulation, non-EA Member States have not benefited from its effects. In non-EA countries, domestic payments in euro are either very expensive or simply not possible. Consequently, individuals and businesses in non-EA Member States pay high fees on cross-border payments and transactions when abroad. These costs are an impediment to the completion of the single market and create two classes of payment service users in the EU.

In March 2018, the Commission tabled a proposal seeking to extend the benefits of Regulation (EC) No 924/2009 to people and businesses in non-EA Member States and put an end to the high costs of their intra-EU cross-border payments in euro. Following an agreement between the European Parliament and the Council, Regulation (EU) 2019/518[87] amended Regulation (EC) No 924/2009 so as to:

- ensure that, as from 15 December 2019, individuals or companies transferring euros from non EA Member States **pay the same** as they would for domestic transactions in the local currency; and
- establish **additional transparency obligations** for currency conversion practices, in line with Articles 45 and 59 of Directive (EU) 2015/2366. The aim is to help users compare currency conversion service offers before initiating a payment transaction involving a currency conversion. The transparency requirements have mostly applied since 19 April 2020 and will particularly benefit consumers who travel to Member States with a different currency than that of their home country.

4.4.4 Single euro payments area

By establishing technical and business requirements for credit transfers and direct debits in euro, Regulation (EU) No 260/2012[88] (the Single Euro Payments Area (SEPA) Regulation) was 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 introducing the international bank account number (IBAN). This has led to significant savings, as banks no longer bear the high costs of running ‘legacy’ and SEPA products in parallel. In addition, since 2012, payment service providers have had to ensure that, where their accounts are reachable for domestic credit transfers and direct debits, they 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 payer with an account in the country of the payee.

At the end of 2017, the Commission issued a report on the application of the SEPA Regulation. It concluded that the migration had been a success overall, but identified some minor challenges, including cases of IBAN discrimination (e.g. by utility companies and telecom providers). It also found that some Member States had not designated a competent authority capable of addressing non-compliance by payees and that, even in those that had, the authority was sometimes unable to enforce the

[87] Regulation (EU) 2019/518 of the European Parliament and of the Council of 19 March 2019 amending Regulation (EC) No 924/2009 as regards certain charges on cross-border payments in the Union and currency conversion charges (OJ L 91, 29.3.2019, p. 36).

[88] Regulation (EU) No 260/2012 of the European Parliament and of the Council of 14 March 2012 establishing technical and business requirements for credit transfers and direct debits in euro and amending Regulation (EC) No 924/2009 (OJ L 94, 30.3.2012, p. 22).

Regulation, specifically in cases of IBAN discrimination. Since 2018, the Commission has focused 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.

In following up specific complaints, the Commission has launched EU pilots for several Member States to establish what steps they are taking to ensure that payees also comply with the Regulation. There are ongoing infringement cases to ensure that Greece, Latvia and Poland designate a competent authority to address payees' non-compliance[89]. An infringement case has been launched against Spain to address non-compliance by the tax authorities.

On 24 September 2020, the Commission adopted a retail payments strategy[90], the overarching goal of which is to create an innovative, integrated and competitive retail payments sector in the EU, with 'home-grown' EU-wide payment solutions. The strategy will also bolster the EU's open strategic autonomy and promote the international role of the euro. It includes policy actions organised around four main pillars:

1. European payment solutions that work cross-border and take advantage of instant payments capability. The main objective is to remove fragmentation and roll-out instant payments in a pan-European fashion.

2. A competitive and innovative retail payments market, with strong customer protection. The main objective is to ensure that the licensing regime for payment services ensures the soundness and stability of payment service providers while fostering innovation and competition, and consumer protection. The main legislation in this field (the payment services directive or PSD2) has become a world standard in terms of open banking.

3. Access to efficient, secure and interoperable payment infrastructures and other technical infrastructures. The main objective is to ensure that all providers of payment services get direct access to payment infrastructures and key technical infrastructures (such as NFC), which are currently restricted.

4. Improving international payments between the EU and other jurisdictions, including remittances. As these are currently still too expensive and inefficient. This will also support the international role of the euro.

On 19 January 2021, the European Commission and the European Central Bank (ECB) announced that they launched a cooperation at technical level on a possible digital euro, pursuing efforts towards ensuring a strong and vibrant European digital finance sector and a well-integrated payments sector to respond to new payment needs.

4.5 Direct taxation and free movement of capital

The Commission's action to tackle tax evasion and avoidance has been very successful. Its work on **fairer taxation** helps to remove the distortions that many companies face due to aggressive tax planning by their competitors. A coordinated EU approach also

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[89] See Section 3.3 for more information on infringements relating to the free movement of capital.

[90] Communication from the Commission to the European parliament, the Council, the European economic and social committee and the Committee of the regions on a Retail Payments Strategy for the EU, COM/2020/592 final, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52020DC0592

helps to prevent 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 achieving more integrated capital markets in the EU.

We have now seen the launch of all of the initiatives announced in the 2015 action plan for fair and efficient corporate taxation in the EU[91]. Several initiatives have been adopted to strengthen the EU's anti-abuse provisions (in particular the Anti-Tax Avoidance Directives[92]) and boost tax transparency. In 2018, the Member States adopted an amendment to the Directive on administrative cooperation in direct taxation to require intermediaries (e.g. advisers, consultants, lawyers and accountants) to report to their competent authorities on cross-border arrangements that include at least one of the risk indicators ('hallmarks') laid down by law. In July 2020, the Commission has proposed a new amendment to the Directive on Administrative Cooperation, to introduce an automatic exchange of information between Member States' tax administrations for income/revenues generated by sellers on digital platforms and strengthen administrative cooperation through the clarification of existing rules. This will not only allow national authorities to identify situations where tax should be paid, but will also reduce the administrative burden placed on platforms, who would otherwise have to deal with different national reporting requirements. Political agreement on a text was reached in December 2020.

Tackling the issue of the debt bias in taxation is one of the goals of the CMU, since this incentivises undercapitalisation, which can make companies more fragile and destabilise the economy. The Commission's 2016 relaunched CCCTB proposal includes provisions on an allowance for growth and investment (AGI), which aims to give companies similar tax benefits for equity as for debt, creating a more neutral and investment-friendly tax environment. Council discussions on these proposals have been postponed pending the outcome of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) work to address the tax challenges of the digitalisation of the economy, limit excessive tax competition and close remaining BEPS loopholes. The OECD project aims to partly reallocate taxing rights and introduce a minimum effective corporate tax rate on multinationals' profits. A final agreement in the OECD is expected by mid-2021 and EU action in this area will focus on implementing it. While a worldwide agreement remains the Commission's preferred way forward, it stands ready to propose EU action in case an agreement is not reached within the OECD framework. Moreover, the Commission will put forward a proposal for a digital levy to be used as a new EU own resource, as mandated by the European Council in July 2020[93].

The Commission's July 2020 Communication on ***Tax good governance in Europe and beyond***[94] outlines key achievements in recent years on fair taxation and proposes to review and revisit the main tools enabling these, i.e. the code of conduct on business taxation and the EU list of non-cooperative jurisdictions.

Also in July, the Commission adopted a Recommendation on making state financial support to undertakings in the EU conditional on the absence of links to **non-cooperative**

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[91] For more information, see: https://ec.europa.eu/taxation_customs/business/company-tax/action-plan-corporate-taxation_en

[92] For more information, see: https://ec.europa.eu/taxation_customs/business/company-tax/anti-tax-avoidance-package/anti-tax-avoidance-directive_en

[93] EUCO 10/20.

[94] COM/2020/313 final.

jurisdictions. This initiative, taken against the backdrop of the COVID-19 pandemic, aims to ensure that Member States disallow state financial support to businesses that have links to listed non-cooperative jurisdictions for tax purposes. An exception applies where firms are engaged in genuine economic activities in the listed jurisdictions.

Considerable progress has been made in the area of **administrative cooperation on direct taxation** in the EU. Since 2016, financial institutions have been obliged to carry out 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[95]. The Directive implements the OECD's standard for the automatic exchange of financial account information. The first automatic exchanges of information between Member State tax administrations took place in September 2017. This closer cooperation allows 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.

The EU's **savings taxation agreements** with five neighbouring countries (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 provide for the automatic exchange of financial account information based on the OECD worldwide standard. The revised agreements have all entered into force and automatic exchanges had started by September 2018. No further changes took place in the current reporting period.

Following a Commission proposal in October 2016, the Member States adopted a Directive on **tax dispute resolution** mechanisms[96] in October 2017 that is applicable since 1 July 2019. The Directive lays down rules for the swifter, more efficient resolution of disputes arising from the interpretation and application of tax treaties between Member States on the elimination of double taxation for businesses and individuals. It creates an obligation to resolve disputes within a set period and, importantly, guarantees taxpayers' procedural right to trigger several stages of the dispute resolution procedure(s).

In the context of the CMU, the Commission is taking action to encourage Member States to simplify **WHT relief/refund procedures** for cross-border investors (see Section 4.2.3) and adopt best tax practices in promoting **venture capital and business angel investment** in start-ups and innovative companies. A 2017 study found that tax incentives play a role in both supporting and hampering venture capital and business angel investment. The way in which they are designed could help reduce the (upside and downside) risk 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.

The Commission is also preparing a Communication on **business taxation**, to be published later in the year. It will take stock of the OECD-led discussion on reform of

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[95] Council Directive 2014/107/EU of 9 December 2014 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation (OJ L 359, 16.12.2014, p. 1).

[96] Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union.

the international tax framework and look beyond this at the wider EU agenda on business taxation.

Taxation is one of the policy areas monitored by the **European Semester**. The main taxation priorities of the 2020 cycle were to:

- stimulate productive investment and address positive and negative externalities;
- improve tax administration and tax certainty;
- boost employment;
- reduce inequalities; and
- ensure tax compliance, *inter alia* by curbing aggressive tax planning practices.

In 2020, the Commission issued country-specific recommendations in the area of taxation to 10 Member States; these were approved by the Council.

Taxation will also be covered in the **national RRPs** (see Section 4.1.1), in particular if the Member State has received a country-specific recommendation in this area.

4.6 Macroprudential measures

Macroprudential policy aims to limit systemic risk emanating from the financial system through prudential measures that address vulnerabilities that are generally not specific to individual institutions.

The regulatory reforms introduced in response to the global financial crisis significantly improved the resilience of the EU banking sector, which entered the COVID-19 crisis in a relatively good position. Macroprudential policy was part of the policy mix mobilised to mitigate the impact of the COVID-19 shock. Some of the macroprudential requirements introduced before the crisis were relaxed in the course of 2020 to provide the banking sector with capital relief, thereby stimulating lending to the real economy. So far, the EU banking sector has proven resilient to the shock and broadly maintained lending to households and enterprises.

Most macroprudential measures in banking aim to tighten (and release when they are lifted) banks' capital requirements. Consequently, they may have an impact on capital movements. Capital movements are sometimes a source of risk that can be mitigated by macroprudential measures, e.g. to avoid excessive credit growth in a given Member State. Reciprocation measures aim to ensure that macroprudential measures taken in one country (e.g. to address an overheating housing market) will not be rendered ineffective by increased lending through foreign bank branches or direct cross-border lending into that country.

The 2013 Capital Requirements Directive[97] and Capital Requirements Regulation (CRR) provide for a number of macroprudential instruments in the banking sector to address cyclical and structural risks:

- mandatory instruments such as:

[97] 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).

    - the capital conservation buffer (CCoB);
    - the countercyclical capital buffer (CCyB); and
    - the buffer for global systemically important institutions (G-SIIs);
- optional instruments, such as:
    - the buffer for other systemically important institutions (O-SIIs) – although the *identification* of O-SIIs is mandatory;
    - the systemic risk buffer (SyRB);
    - measures under Articles 124 and 164 CRR (which can address vulnerabilities relating to the real-estate sector); and
    - national measures under Article 458 CRR (which can be used only if no other measure in the EU macroprudential toolkit can adequately address emerging national systemic risks).

Given that macroprudential risks can arise in one or more countries at the same time while the policy measures are national in nature, the framework aims to give individual Member States the necessary flexibility to act. At the same time, it provides appropriate safeguards (in the form of EU coordination or authorisation prior to the activation of selected measures) to ensure that the internal market and the free flow of capital are not unduly affected. These safeguards also include a reciprocation (mutual recognition) framework to avoid cross-border leakages and circumvention of measures.

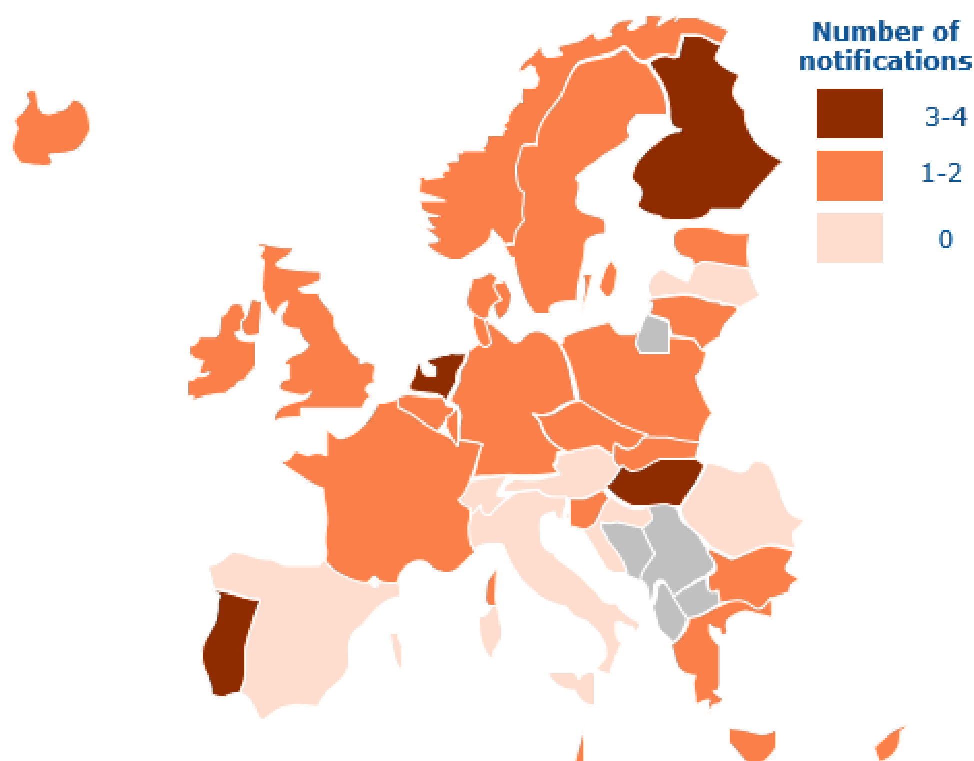
In June 2019, amendments to the Regulation and the Directive (CRR/CRD IV) entered into force[98]. They include a number of targeted improvements to the macroprudential provisions that became applicable on 29 December 2020[99].

Several Member States have supplemented the EU macroprudential toolkit with national macroprudential instruments. Most of these relate to mortgage transactions and consist of borrower-based measures, 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.

[98] The banking package contains changes to the CRD (Directive 2013/36/EU), the CRR (Regulation (EU) No 575/2013), the Bank Recovery and Resolution Directive (Directive 2014/59/EU) and the Single Resolution Mechanism Regulation (Regulation (EU) No 806/2014). It was published on 20 May 2019 (OJ L 150) and entered into force 20 days later.

[99] However, the June 2020 ‘quick fix’ to the CRR defers by one year, to January 2023, the application of the leverage ratio buffer requirement for G-SIIs (which — in line with the Basel Agreement — would have become applicable on 1 January 2022).

Figure 13: Macroprudential measures of economic significance, EEA countries (2020)



Source: ESRB. European Commission calculations (up to October 2020).

Notes: The figure only takes account of measures notified in 2020 that are of economic significance. Measures of a more procedural or administrative nature, such as setting the CCyB rate at 0%, are not included. Other measures that have to be notified periodically, such as O-SIIs and the CCyB buffer rate, are not included if they are merely extended. Reciprocation measures are not regarded as measures of economic significance[100].

As mentioned above, most macroprudential measures notified in the course of 2020 generally aimed to mitigate the impact of the pandemic on the EU banking sector and the real economy. Accordingly, many capital-based measures taken in previous years to mitigate the risk stemming from aggregate credit growth were relaxed. To a lesser extent, some Member States also relaxed measures addressing the systemic importance of financial institutions. Risks stemming from the real-estate sector have been subject to both a relaxation and a tightening of measures, depending on the Member State and the instrument. However, the majority of previous years' measures targeting risks stemming from the real-estate sector remain unchanged.

At the end of 2019, a total of 12 Member States had set a non-zero CCyB rate to address aggregate credit growth; as a consequence of the economic challenges posed by the pandemic. In 2020 (cut-off date October 2020) 10 Member States announced the release

[100] The UK ceased to be a contracting party to the EEA Agreement after its withdrawal from the EU on 31 January 2020. However, during the transition period, the UK continued to be treated as an EEA State. Accordingly, the rights and obligations contained in the EEA Agreement continued to apply between the UK and the EEA EFTA States until 31 December 2020.

or reduction of their CCyB rates[101]. Only Luxembourg announced an increase, as of January 2021.

All Member States have identified SIIs in their economy and around 160 G-SIIs and O-SIIs are currently identified in the EU. The additional capital buffer requirements for such institutions vary from 0% to 2% (subject to phasing-in). In 2020, eight Member States decided to reduce the buffer rates for some banks identified as O-SIIs or to extend the phase-in period for the O-SII buffer. In the majority of cases, these decisions were aimed at mitigating the impact of the pandemic.

By October 2020, 23 Member States had activated measures to address vulnerabilities stemming from the real-estate sector (unchanged with respect to 2019). The majority (22) had resorted to borrower-based measures enshrined in national law. In 2020, six Member States adopted additional borrower-based measures or tightened/relaxed measures already in place, to mitigate the impact of the pandemic. Borrower-based measures appear to be relatively effective – they reduce vulnerabilities on the balance sheets of both banks and households, even if they mainly apply to new mortgage loans.

At the end of 2019, SyRBs were used in 13 Member States (plus the UK) for a wide range of purposes. However, as a consequence of the challenges to the economy posed by the pandemic, five Member States released or reduced their SyRBs in 2020 and one (Ireland) decided to postpone the introduction of the SyRB[102].

One Member State (the Netherlands) notified a national measure under Article 458 CRR, but its application was put on hold in the light of the pandemic[103]. Three Member States (Belgium, France and Sweden) notified a 1-year extension of national measures already activated under Article 458 CRR. The aim in most cases is to address risks stemming from the residential real-estate sector. Given their potential negative impact on the internal market, the measures are subject to an EU non-objection procedure. 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 a Council implementing act rejecting the draft national measures.

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

[101] In addition, two EFTA countries (Norway and Iceland) that had previously activated a positive CCyB rate decided to release or reduce them in the face of the COVID-19 pandemic. In March 2020, the UK also released its positive CCyB rate.

[102] By October 2020, two EFTA countries (Liechtenstein and Norway) that already had a SyRB in place (together with Iceland) notified a recalibration of their SyRB (a decrease in the case of Liechtenstein and an increase in the case of Norway). The UK maintained its SyRB.

[103] In addition, by October 2020 one EFTA country (Norway) had notified two national measures under Article 458 CRR.

In this vein, on 27 May 2020, the ESRB General Board issued a Recommendation on the restriction of distributions during the COVID-19 pandemic[104] to support and complement previous initiatives of the European Central Bank, the EBA and national authorities, aimed at enhancing the resilience of the financial sector, strengthening its capacity to lend to the real economy and reducing the risk of failures of financial institutions due to COVID-19 related risks. The ESRB Recommendation, which covers banks, certain investment firms and insurers, reinsurers and central counterparties takes into account the critical role these sectors of the financial system play in the real economy, in particular in times of crisis. Relevant authorities are asked to request financial institutions to refrain from paying dividends, buy-backs of ordinary shares and variable remuneration to material risk takers at least until 1 January 2021. On 15 December 2020, the General Board of the ESRB decided to extend the recommendation to restrict distributions until 30 September 2021[105], by removing CCPs from its scope and introducing more flexibility for supervisors, allowing distributions up to a conservative threshold. Restrictions may be applied at sub-consolidated or at individual level, thus limiting the possibilities for allocating capital within banking groups. The Recommendation requires relevant authorities to cooperate with each other and with relevant resolution authorities, and to take into account the smooth functioning of the internal market as well as any adverse effects on financial stability in other Member States or the EU as a whole.

4.7 Countering money laundering and the financing of terrorism

The need to combat money laundering and terrorist financing has been on the EU's agenda for over 30 years. In this time, the EU has developed a regulatory framework, going beyond the international standards adopted by the United Nation's Financial Action Task Force (FATF)[106], to prevent and manage the associated risks. The EU framework on anti-money laundering and countering the financing of terrorism (AML/CFT) must constantly evolve to keep pace with the growing sophistication of financial crime, technological developments generating new ways of laundering money and the increasing openness of the EU internal market. The recent increase in criminal activity in the context of the pandemic[107] is a reminder that criminals will exploit all possible avenues to pursue illicit activities to the detriment of society, and that the EU needs to be equally determined to ensure that criminals do not benefit from the proceeds of these crimes.

[104] Recommendation of the European Systemic Risk board of 27 may 2020 on restriction of distributions during the covid-19 pandemic (ESRB/2020/7), https://www.esrb.europa.eu/pub/pdf/recommendations/esrb.recommendation200608_on_restriction_of_distributions_during_the_COVID-19_pandemic_2~f4cdad4ec1.en.pdf

[105] https://www.esrb.europa.eu/news/pr/date/2020/html/esrb.pr201218~341881f7b9.en.html.

[106] The FATF, created in 1986, with the Commission and 14 Member States as members, is the global money laundering and terrorist financing standard-setter.

[107] Europol, *Pandemic profiteering: how criminals exploit the COVID-19 crisis* (March 2020). The EBA reminded credit and financial institutions of the importance of effective systems and controls and asked competent authorities to support them in this regard (*EBA statement on actions to mitigate financial crime risks in the COVID-19 pandemic*).

4.7.1 5th Anti-Money Laundering Directive

Directive (EU) 2018/843[108] (5th Anti-Money Laundering Directive – 5AMLD) amended Directive (EU) 2015/849[109] (4AMLD), introducing substantial improvements to equip the EU to better prevent the financial system from being used for money laundering and funding terrorist activities.

Member States were to transpose the new Directive by 10 January 2020. The Commission took a very proactive and strong stance on transposition. After the deadline, it initiated infringement proceedings against 17 Member States due to their failure to notify (complete) national transposition measures on time[110].

4.7.2 Action plan for a comprehensive Union policy on preventing money laundering and terrorist financing

On 7 May 2020, the Commission adopted an action plan for a comprehensive Union policy on preventing money laundering and terrorism financing[111]. It is built on six pillars:

1. ensuring effective implementation of existing rules;
2. establishing a single EU rulebook;
3. bringing about EU-level supervision;
4. establishing a support and cooperation mechanism for financial intelligence units (FIUs);
5. enforcing criminal law provisions and information sharing; and
6. strengthening the international dimension of EU action.

In line with the roadmap in the action plan, the Commission intends to propose several measures, including legislative and non-legislative initiatives, in the first half of 2021. To gather the views of stakeholders and the general public on the measures, it launched a public consultation in parallel with the adoption of the action plan[112].

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[108] 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 (OJ L 156, 19.6.2018, p. 43).

[109] Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and Commission Directive 2006/70/EC (OJ L 141, 5.6.2015, p. 73).

[110] Austria, Belgium, Cyprus, Czech Republic, Estonia, Hungary, Ireland, Greece, Luxembourg, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, and Spain. As of January 2021, 20 Member States had declared complete transposition, while the Czech Republic, Hungary, Ireland, the Netherlands, Poland, and Spain had declared a partial transposition and Cyprus is still to notify the adoption of any transposition measures.

[111] Commission Communication, *Action plan for a comprehensive Union policy on preventing money laundering and terrorist financing* (C(2020) 2800 final); https://ec.europa.eu/finance/docs/law/200507-anti-money-laundering-terrorism-financing-action-plan_en.pdf

[112] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12176-Action-Plan-on-anti-money-laundering/public-consultation

The actions outlined in the action plan build on findings from the anti-money laundering package of 2019, which highlighted fragmentation of rules, uneven supervision and limitations in cooperation among FIUs across the EU.

4.7.3 Report on trusts and similar legal arrangements

On 16 September 2020, the Commission adopted a report[113] assessing whether Member States had duly identified all trusts and similar legal arrangements under their jurisdiction and made them subject to the obligations of 4AMLD. This is a requirement under 5AMLD, which extended to trusts and similar legal arrangements the transparency rules and obligations applicable to legal entities.

4.7.4 Other recent legislative developments to strengthen the AML/CFT framework

On 7 May 2020, the European Commission adopted a new delegated regulation in relation to third countries which have strategic deficiencies in their AML/CFT regimes that pose significant threats to the financial system of the Union ('high-risk third countries')[114].

As well as the amendments introduced by 5AMLD (see above), legislative developments have included:

- an upgraded mandate for the EBA[115];
- new provisions applying to cash controls[116] from June 2021;
- amendments to the Capital Requirements Directive (CRD V)[117];
- new rules on law enforcement authorities' access to financial information[118];
- new rules on the mutual recognition of freezing and confiscation orders[119]; and

[113] *Report to the European Parliament and the Council assessing whether Member States have duly identified and made subject to the obligations of Directive (EU) 2015/849 all trusts and similar legal arrangements governed under their laws* (COM/2020/560 final); https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52020DC0560

[114] Identification of such countries is a legal requirement stemming from Article 9 of Directive (EU) 2015/849 (4AMLD) and aiming at protecting the Union financial system and the proper functioning of the internal market. The delegated regulation amends delegated Regulation (EU) 2016/1675.

[115] Regulation (EU) 2019/2175 of the European Parliament and of the Council of 18 December 2019 amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority), Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority), Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds, and Regulation (EU) 2015/847 on information accompanying transfers of funds (OJ L 334, 27.12.2019, p. 1).

[116] Regulation (EU) 2018/1672 of the European Parliament and of the Council of 23 October 2018 on controls on cash entering or leaving the Union and repealing Regulation (EC) No 1889/2005 (OJ L 284, 12.11.2018, p. 6).

[117] Directive (EU) 2019/878 of the European Parliament and of the Council of 20 May 2019 amending Directive 2013/36/EU as regards exempted entities, financial holding companies, mixed financial holding companies, remuneration, supervisory measures and powers and capital conservation measures (OJ L 150, 7.6.2019, p. 253).

[118] Directive (EU) 2019/1153 of the European Parliament and of the Council of 20 June 2019 laying down rules facilitating the use of financial and other information for the prevention, detection, investigation or prosecution of certain criminal offences, and repealing Council Decision 2000/642/JHA (OJ L 186, 11.7.2019, p. 122).

- a harmonised definition of offences and penalties related to money laundering[120].

In addition, the EU established a new comprehensive **whistle-blower protection** regime, to be transposed by December 2021[121], which complements existing rules on whistle-blower protection in 4AMLD. The new regime will strengthen the ability of national and EU authorities to prevent, detect and address breaches of rules on, *inter alia*, money laundering and the financing of terrorism.

Nevertheless, there is growing consensus that the framework requires significant improvement. There is a need to address major divergences in the way it is applied and serious weaknesses in the enforcement of the rules.

4.7.5 Enhancing the AML/CFT framework

The European Parliament and the Council have both highlighted the need to further enhance the current AML/CFT framework. In its Resolution of 19 September 2019[122], the Parliament called for more impetus to be given to initiatives that could reinforce AML/CFT action at EU level and for speedy transposition of EU rules by Member States. On 5 December 2019, the Economic and Financial Affairs Council adopted conclusions on strategic priorities for AML/CFT[123], inviting the Commission to explore action that could enhance the existing framework.

The Commission intends to pursue a comprehensive AML/CFT policy, tailored to the specific threats, risks and vulnerabilities currently facing the EU and designed to be able to evolve efficiently and take account of innovation. A stronger AML/CFT framework would further promote the integrity of the EU financial system, which is necessary to complete the implementation of the banking union and EMU.

In view of the nature of the problems identified, the current AML/CFT framework requires reform to ensure more uniform and consistent implementation of the rules across the internal market, by reducing the margin of interpretation left to Member States. This requires structural change and new rules. To this end, the May 2020 action plan contains a commitment to propose legislation in the first half of 2021[124] (in all cases ‘based on thorough impact assessment of options’) to:

- create a single rulebook;
- appoint an EU-level AML/CFT supervisor; and
- establish an EU coordination and support mechanism for FIUs.

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119 Regulation (EU) 2018/1805 of the European Parliament and of the Council of 14 November 2018 on the mutual recognition of freezing orders and confiscation orders (OJ L 303, 28.11.2018. p. 1).

120 Directive (EU) 2018/1673 of the European Parliament and of the Council of 23 October 2018 on combating money laundering by criminal law (OJ L 284, 12.11.2018, p. 22).

121 Directive (EU) 2019/1937 of the European Parliament and of the Council of 23 October 2019 on the protection of persons who report breaches of Union law (OJ L 305, 26.11.2019, p. 17).

122 European Parliament Resolution of 19 September 2019 on the state of implementation of the Union’s anti-money laundering legislation (2019/2820(RSP)).

123 Council Conclusions of 5 December 2019 on strategic priorities on anti-money laundering and countering the financing of terrorism (14823/19).

124 This urgency reflects ‘growing consensus that the framework needs to be significantly improved. Major divergences in the way it is applied and serious weaknesses in the enforcement of the rules need to be addressed’ (introduction to action plan). This consensus was reflected in the responses to the public consultation on the action plan (see Section 4.7.2).

A legislative package on money laundering was included as a key initiative in the Commission's 2021 work programme[125], published on 19 October 2020.

During a videoconference on 4 November 2020, economics and finance ministers discussed the Council conclusions on anti-money laundering and terrorism financing, with a view to providing the Commission with guidance in advance of its legislative proposals in 2021. In its conclusions[126], the Council outlined various areas in which the Commission should consider harmonising the EU rules via a directly applicable Regulation. It also supported appointing an EU-level supervisor with direct supervisory powers over a selected number of high-risk obliged entities, and the authority to take over supervision from a national supervisor in clearly defined and exceptional situations.

5 GLOBAL DEVELOPMENTS

5.1 UK withdrawal from the EU

The UK's withdrawal from the EU entails significant changes for market participants. Notwithstanding the EU-UK Trade and Cooperation Agreement (TCA) concluded on 24 December 2020, the arrangements in terms of market access and regulatory controls are those typical of other third countries and very different from when the UK was a Member State. Nevertheless, it appears that market participants had adequately prepared for this regime change and the UK's exit from the Single Market did not result in any financial stability issues or significant disruption. This will require ongoing monitoring.

In line with the EU's standard approach to free-trade agreements (FTAs), the TCA allows respective investors from the EU and the UK to establish and operate freely, subject to a limited number of exceptions, which bind the existing level of liberalisation for most sectors, providing for a high level of legal certainty. The coverage of financial services in the TCA also provides substantial commitments for establishment for the purposes of providing financial services, but only very limited commitments for the cross-border provision of services. Importantly, each side retains the right to adopt measures for reasons of financial stability, investor protection and market integrity by virtue of a broad prudential carve-out.

The TCA does not go substantially beyond existing General Agreement on Trade in Services (GATS) commitments in terms of liberalising financial services and does not address regulatory cooperation. Under the EU approach, the bilateral relationship with the UK in financial services should be managed through a structured, yet non-binding regulatory cooperation framework, with equivalence decisions remaining unilateral and autonomous tools. In that regard, the Joint Declaration on Financial Services Regulatory Cooperation (annexed to the TCA) commits the EU and the UK to agree on such a framework for cooperation by March 2021.

In September 2020, the EU decided to grant equivalence in the area of central clearing on a time-limited basis (until mid-2022), thus paving the way for the European Securities and Markets Authority (ESMA) to recognise UK central counterparties (CCPs). This decision was taken to ward off possible financial stability risks, which could have arisen in the absence of such equivalence/recognition. At the same time, the EU stressed the need for the industry to put in place a process whereby EU clearing members reduce their

[125] https://ec.europa.eu/info/publications/2021-commission-work-programme-key-documents_en
[126] https://data.consilium.europa.eu/doc/document/ST-12608-2020-INIT/en/pdf

exposures to UK CCPs. The Commission also adopted in November 2020 a temporary equivalence for central securities depositories (CSDs) for 6 months, so that EU securities held by a UK CSD can migrate securities to an EU CSD.

In accordance with standard EU practice, a dedicated chapter in the TCA liberalises capital movements and payments relating to the transactions liberalised under the Agreement, subject to certain exceptions such as for the operation of the EMU and for the Balance of Payments (BoP) difficulties. The TCA does not cover investment protection or investor-to-state dispute settlement.

5.2 The LIBOR transition

In 2017, the UK Financial Conduct Authority (FCA) announced that it would not persuade or compel panel banks to submit data necessary to the calculation of the London Interbank Offered Rate (LIBOR – the interest rate benchmark most used globally) beyond the end of 2021. Subsequent announcements by the FCA and the administrator of LIBOR have made it clear that LIBOR will be wound down in most of the currencies and tenors for which it is calculated by the end of 2021, with other tenors and currencies of LIBOR to follow in 2023.

There are a vast number of contracts that affect economic operators in the Union - debt, loans, term deposits, securities and derivatives - that all reference LIBOR, mature later than 31 December 2021, and that do not contain sufficiently robust fall-back provisions to cover the cessation or the wind-down of LIBOR as calculated in the relevant currency or of some of its tenors. Some of those contracts and financial instruments cannot be renegotiated in order to incorporate a contractual fall-back provision before 31 December 2021.

In order to avoid the negative consequences of the cessation of LIBOR in the EU, a political agreement was reached in December 2020 on a legislative initiative granting the Commission the power to designate a contractual replacement for a benchmark in cessation. The amending regulation entered into force in February 2021[127].This new tool will help to ensure the continued orderly functioning of contracts that reference such a widely used benchmark, financial stability and well-functioning financial markets in the EU.

5.3 Free-trade agreements and stand-alone investment agreements

Since the entry into force of the Lisbon Treaty, which gave the EU exclusive competence for FDI (Article 207 TFEU), the Commission has pursued an ambitious investment negotiation agenda, which is based on the three pillars: liberalisation, protection and facilitation of investment.

Investment facilitation disciplines focus on making it easier for investors to establish, operate and expand investments. Among other things, they aim to improve the transparency and predictability of the investment environment, simplify and streamline administrative procedures, and provide for review procedures.

[127] Regulation (EU) 2021/168 of the European Parliament and of the Council of 10 February 2021 amending Regulation (EU) 2016/1011 as regards the exemption of certain third-country spot foreign exchange benchmarks and the designation of replacements for certain benchmarks in cessation, and amending Regulation (EU) No 648/2012 (OJ L49, 12.02.2021).

The investment liberalisation provisions seek to level the playing field for foreign investors on third country markets. They cover principles and commitments that allow for the opening of third country markets to investors in both services and manufacturing, as well as primary and secondary industry sectors. These standard obligations include market access (elimination of quantitative restrictions), and non-discrimination (national treatment and most-favoured nation treatment), as well as the prohibition of certain performance requirements.

While all EU trade agreements preserve the right of governments to regulate for legitimate public policy objectives, the investment protection commitments provide investors with additional guarantees, protecting them and their investments from unfair and inequitable treatment or unlawful expropriation in relation to their assets in third countries. The Commission negotiates investment protection based on modern and innovative provisions ensuring a balance between a high level of investment protection and governments' right to regulate, and offering the reformed dispute resolution mechanism (investment court system). EU agreements with third countries that include investment protection disciplines replace Member States' BITs with the same countries.

The Commission negotiates investment disciplines with third countries multilaterally or bilaterally, as part of wider trade agreements (FTAs), or as stand-alone investment agreements.

Negotiations for a comprehensive agreement on investment with **China** were launched in 2014 and concluded, in principle, in December 2020. The agreement features ambitious commitments on market access as well as disciplines on level playing field and sustainable development.

The FTA with **Japan**, which covers investment liberalisation disciplines, entered into force in February 2019. Discussions continue on investment protection as part of a possible future investment protection agreement.

Investment negotiations with **Singapore** and **Vietnam** were concluded in 2018 and 2019 respectively. The wider trade agreement that liberalises investment with Singapore entered into force in November 2019, and that with Vietnam - in August 2020. The stand-alone investment protection agreements with these two countries are subject to ratification by the Member States in line with their respective internal procedures.

Negotiations to update the trade aspects of the Association Agreement with **Chile** have been ongoing since 2017. They cover provisions on investment liberalisation and protection. Two rounds took place in 2020 and negotiations are continuing in 2021.

In June 2019, the EU reached a political agreement with **Mercosur** on an ambitious, balanced and comprehensive trade agreement, which features investment liberalisation disciplines. The negotiated text is undergoing legal revision and, after translation into the official EU languages, will be submitted to the Council and the European Parliament for approval.

Negotiations for an agreement with **Mexico** started in 2016 and agreement in principle on trade arrangements was reached in 2018. It includes a comprehensive investment chapter providing for the liberalisation and protection of investment. Once legal scrubbing and translation of the negotiated text are finalised, this agreement will also be submitted to the Council and the European Parliament for approval.

Negotiations with **Indonesia** have been ongoing since 2016. They cover both investment liberalisation and protection. One virtual round took place in 2020.

The EU launched negotiations for FTAs with **Australia** and **New Zealand** in 2018. These cover investment liberalisation, but not investment protection. In 2020, three rounds of negotiations were held with each party. These negotiations are quite well advanced.

In October 2019, the Commission launched negotiations on the deepening of the Economic Partnership Agreement with the **Eastern and Southern African** countries[128]. These cover investment liberalisation and investment facilitation. Two rounds of negotiations have taken place so far.

As announced in the Commission Trade Policy Review of 18 February 2021, the Commission will propose a new sustainable investment initiative to partners or regions in Africa and the Southern Neighbourhood interested in doing so. This could be done in the form of stand-alone investment agreements or as part of the modernisation of existing trade agreements.

In 2020, the EU participated in **WTO** negotiations for a multilateral framework on investment facilitation for development, which were launched at a ministerial conference in Buenos Aires. The framework would build on measures such as transparency for investment conditions and opportunities, and streamlined administrative procedures for investment. Liberalisation and protection are not covered.

July 2020 saw the first of three rounds of negotiations for the **modernisation of the Energy Charter Treaty (ECT)**. The negotiations cover investment protection provisions.

5.4 Member States' bilateral investment treaties (BITs) with third countries

As a general rule, agreements on investment protection negotiated at EU level with various third countries replace the Member States' BITs with the same countries. However, under Regulation (EU) No 1219/2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries[129], the Commission can still authorise Member States to negotiate/conclude new BITs under certain conditions:

- where there are no Commission recommendations to open EU-level negotiations with the same country; and
- where the BIT is compatible with EU law, and consistent with EU investment policy.

The Commission decides on the basis of a notification by the Member State in question after consulting the other Member States in a comitology procedure.

[128] Comoros, Madagascar, Mauritius, Seychelles and Zimbabwe.

[129] Regulation (EU) No 1219/2012 of the European Parliament and of the Council of 12 December 2012 establishing transitional arrangements for bilateral investment agreements between Member States and third countries (OJ L 351, 20.12.2012, p. 40).

5.5 Free movement of capital and the OECD

In 2019, the OECD Council approved the review of the OECD **Code of Liberalisation of Capital Movements**, which commits adherent countries to the gradual liberalisation of cross-border capital flows[130]. The main objective of the review was to strengthen the Code and ensure that it remains relevant in a substantially changed environment. The Commission participated actively in the review and arranged additional coordination to ensure consistency between Member States' positions, in particular on matters covered by a common legal framework in the EU.

The reviewed Code allows adherent members to take measures necessary to preserve financial stability ('macroprudential measures'), while preserving liberalisation standards. It clarifies that certain widely used macroprudential measures (currency-based Basel III-type liquidity ratios, such as the liquidity coverage ratio and the net stable funding ratio) are not considered restrictions. It also provides flexibility for untested measures, acknowledging that the macroprudential toolkit is evolving.

Other important outcomes of the review include:

- *an improved procedure for assessing measures taken by adherent countries:*
  - clearer criteria for conformity assessment;
  - a stronger monitoring role for the OECD Secretariat;
  - clearer deadlines for notification; and
  - prompt declassification of assessment reports;
- *closer cooperation with other international organisations* – explicit provision for consulting other international organisations, in particular the IMF for its expertise on BoP issues. This is of particular importance for addressing any issues that could arise as regards compatibility with the IMF Institutional View[131]; and
- *more effective decision-making* – a country under review may not block the conclusion of the assessment of country-specific measures.

Since the adoption of the review, the Commission has continued to contribute actively to the work of the Advisory Task Force of the Codes (ATFC). This work includes examining specific measures taken by individual adherents with relevance to their obligations under the Codes. The ATFC also helps to assess the positions of non-OECD countries applying for adherence to the Codes.

5.6 Recent development of the IMF Integrated Policy Framework

The goal of the analytical work conducted by the IMF to develop its Integrated Policy Framework (IPF) enriches the understanding of policymakers' on complex interactions among shocks, policies and country characteristics. The IPF uses a unified framework to consider the appropriateness of policies in various circumstances, thus enhancing the Fund's analytical toolbox. According to the IPF, the optimal policy combinations depend

[130] https://www.oecd.org/daf/inv/investment-policy/codes.htm

[131] The IMF's Institutional View on capital flows provides a macroeconomic framework for consistent policy advice on liberalising and managing capital flows, with the goal of helping countries harness the benefits of capital flows while managing the risks: https://www.imf.org/external/np/g20/pdf/2018/073018.pdf

on shocks, country characteristics and initial conditions, and that there is no pre-set hierarchy of policies to address excessively volatile capital flows. In countries with deep foreign exchange markets and continuous market access, economic models do not provide a rationale for interventions in the foreign exchange markets or capital flow control measures and capital flow shocks could be absorbed by the adjustment of the exchange rate. In case of frictions that are common in emerging market and developing economies, the IPF suggests that foreign exchange markets, macroprudential policies and preventive capital flow control measures have a role to play in some circumstances.

The analytical findings from this work are not intended to be a new Fund policy, but rather to help inform the upcoming review of the Fund's Institutional View on the Liberalization and Management of Capital Flows (IV). The IV guides Fund advice to members and, where relevant, Fund assessments in the context of surveillance. Similar to other Fund frameworks, the IV is subject to periodic reviews. Changes to the policy framework could be considered during the forthcoming review of the IV tentatively scheduled for 2021, and the work on the IPF will be a key input for this review.

The European Commission fosters discussion and coordination at EU level on the IPF and the review of the IMF's Institutional View.

5.7 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's FDI regulatory restrictiveness index, which measures statutory restrictions on FDI in 62 countries worldwide and tracks how they have changed since 1997.

However, in some cases foreign investors might seek to acquire critical assets allowing them to access, for example, critical technologies, infrastructure or sensitive information, posing risks to security or public order. In response to such concerns, a number of Member States have introduced investment screening mechanisms. Also, the EU-wide cooperation on screening provided for in the 2019 FDI Screening Regulation[132] has applied since 11 October 2020. This allows the Commission to issue an opinion and Member States to address comments to the Member State in the territory of which FDI transaction is conducted (whether such a transaction is screened under its national screening mechanism or not). The latter will have to take account of the comments/opinion in its final decision as to whether to approve (fully or conditionally) or reject the transaction on security or public order grounds.

The global public health challenge caused by the COVID-19 crisis has revealed some important vulnerabilities relating to the resilience of critical industries in the EU and their capacity to respond to vital public needs. In March 2020, in view of the concerns as to the protection of EU healthcare capacities and the volatility of European stock markets, which could have threatened to trigger a sell-off of critical EU assets, the Commission

[132] Regulation (EU) 2019/452 of the European Parliament and of the Council of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union (OJ L 79, 21.3.2019, p. 1).

issued guidance to Member States on protecting the EU's strategic assets ahead of the full application of the FDI Screening Regulation[133].

In its guidance, the Commission stressed the interdependencies in the single market and called on Member States to seek coordination in cases where foreign investments could have an adverse effect on security or public order. It also called on the Member States that did not have a screening mechanism, or whose mechanism did not cover all relevant transactions, to set up a fully-fledged mechanism and in the meantime to use all other available options to address cases where the acquisition or control of a particular business, infrastructure or technology could create a risk to security or public order in the EU, including a risk to critical health infrastructures and the supply of critical inputs.

According to the Member States' notifications[134], 17 of them had set up mechanisms to screen investments in order to safeguard public security or public policy interests (Denmark, Germany, Slovenia, Spain, France, Italy, Latvia, Lithuania, Hungary, the Netherlands, Austria, Poland, Portugal, Romania, Finland, Malta and Czech Republic).

The mechanisms differ in their design. Some apply to investments from other Member States *and* third countries, while others cover investments from third countries only. Some specify sectors or activities in which investments are subject to screening, while others are not limited to specific sectors or list sectors for illustrative purposes only. The mechanisms use different 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. As a result, the review may take place before completion of the investment (*ex-ante*) or after (*ex post*).

5.8 Economic and financial restrictive measures (sanctions) against third countries

The possibility for the Union to enact restrictive measures ('sanctions') against third countries, legal persons, individuals, groups or non-state entities is one of the general exceptions to the free movement of capital and payments. These sanctions are based on decisions adopted pursuant to Article 29 TEU in pursuit of the objectives of the Common Foreign and Security Policy (CFSP), and implemented via regulations pursuant to Article 215 TFEU.

EU sanctions usually involve targeted measures, such as the freezing of assets (funds and economic resources) of a particular person, entity or body, or sectoral measures, such as a ban on providing financial assistance for military activities, restrictions on financial services, as well as import and export restrictions. The EU Sanctions Map[135] provides detailed information on the EU sanctions regimes currently in force and the restrictive measures applied.

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[133] C(2020) 1981 final; https://trade.ec.europa.eu/doclib/docs/2020/march/tradoc_158676.pdf

[134] List of screening mechanisms notified by Member States, last update 16 February 2021; https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157946.pdf

[135] www.sanctionsmap.eu. The EU sanctions map is an information tool. The EU *Official Journal* is the official source of EU law and, in the event of conflict, its content prevails over that of the sanctions map.

In 2020, all existing sanctions regimes were renewed following annual or 6-monthly reviews. A new 'thematic' sanctions regime targeting serious **human rights violations and abuses** worldwide was adopted in December 2020[136].

As regards financial measures, the most prominent EU's sanction regimes in the reporting period concern Russia, Syria, and the Democratic People's Republic of Korea (DPRK).

Regarding Russia's actions in Ukraine, and in addition to targeted individual measures (e.g. asset freeze against certain individuals and entities undermining Ukraine's territorial integrity), economic and financial sanctions were introduced on 31 July 2014 targeting Russian interests in the financial, oil and defence sectors. The EU's financial restrictive measures aim to cut off strategic state-owned Russian companies from EU financing sources, thus imposing financial costs on the Russian state in order to induce a change in its behaviour. These sanctions regimes[137], have been rolled over every 6 months since their introduction, most recently on 17 December 2020. A third sanctions regime[138] addresses the illegal annexation of Crimea and Sevastopol, and notably prohibits investments in Crimea or Sevastopol.

Regarding Syria[139], the comprehensive financial restrictions imposed by the EU notably cover restrictions related to financial and banking services, participation in certain infrastructure projects as well as the financing of certain enterprises. In addition to these sectoral measures, targeted assets freeze have been imposed on a large number of designated individuals and entities for their role in the repression of the civilian population and the support to the Assad regime, including financial institutions, the Central Bank of Syria, and the Commercial Bank of Syria, which have a crucial role in the movement of capital.

Regarding DPRK[140], the EU sanctions notably prohibit the transfer or clearing of funds to and from North Korea, transactions with banks domiciled in North Korea, and the

[136] Council Decision (CFSP) 2020/1999 of 7 December 2020 concerning restrictive measures against serious human rights violations and abuses (OJ L 410I 7.12.2020, p. 13), and Council Regulation (EU) 2020/1998 of 7 December 2020 concerning restrictive measures against serious human rights violations and abuses (OJ L 410I 7.12.2020, p. 1), https://www.consilium.europa.eu/en/press/press-releases/2020/12/07/eu-adopts-a-global-human-rights-sanctions-regime/.

[137] Council Decision (CFSP) 2014/145 (OJ L 78, 17.3.2014, p. 16) and Council Regulation (EU) 269/2014 (OJ L 78, 17.3.2014, p. 6) of 17 March 2014 concerning restrictive measures in respect of actions undermining or threatening the territorial integrity, sovereignty and independence of Ukraine; Council Decision (CFSP) 2014/512 (OJ L 229, 31.7.2014, p. 13) and Council Regulation (EU) 833/2014 (OJ L 229, 31.7.2014, p. 1) of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine.

[138] Council Decision (CFSP) 2014/386 (OJ L 183, 24.6.2014, p. 70) and Council Regulation (EU) 692/2014 (OJ L 183, 24.6.2014, p. 9) of 23 June 2014 concerning restrictive measures in response to the illegal annexation of Crimea and Sevastopol.

[139] Council Decision 2013/255/CFSP of 31 May 2013 concerning restrictive measures against Syria (OJ L 147, 1.6.2013, p. 14); Council Regulation (EU) No 36/2012 of 18 January 2012 concerning restrictive measures in view of the situation in Syria and repealing Regulation (EU) No 442/2011 (OJ L 16, 19.1.2012, p. 1).

[140] Council Decision (CFSP) 2016/849 of 27 May 2016 concerning restrictive measures against the Democratic People's Republic of Korea and repealing Decision 2013/183/CFSP (OJ L 141, 28.5.2016, p. 79); Council Regulation (EU) 2017/1509 of 30 August 2017 concerning restrictive measures against the Democratic People's Republic of Korea and repealing Regulation (EC) No 329/2007 (OJ L 224, 31.8.2017, p. 1).

opening of branches/subsidiaries of North Korean banks in the EU or EU banks in North Korea. They also require Member States to step up the monitoring of their financial institutions' activities *vis-à-vis* North Korean banks, and EU banks to make detailed reports on such activities.

Independently of EU sanctions regimes, the illegal **extra-territorial application** of **unilateral sanctions** adopted by third countries may have disruptive effects on the free movement of capital and payments within the EU. The EU does not recognise the extra-territorial application of laws adopted by third countries, and considers such effects to be contrary to international law.

The purpose of the 'Blocking Statute' (Council Regulation (EC) No 2271/96[141]) is to protect the EU and EU operators from such an extra-territorial application by:

- nullifying the effects in the EU of any foreign court ruling and administrative decision based on the foreign laws listed in its annex (article 4);
- prohibiting compliance with the foreign laws in question (article 5); and
- allowing EU operators to recover in court any damages caused by the extra-territorial application of these laws (article 6).

The Commission has provided guidance on the implementation of the Blocking Statute[142].

6 CONCLUSIONS

The EU economy faced **significant challenges** in 2020. A resilient banking system, built over the previous decade, helped to absorb the shock through its flexibility and ability to adapt.

The deployment of the measures planned for a fully-fledged capital markets union is likely to reinforce the raft of EU **recovery measures** planned for the years to come, the need for which is well supported by the economic data. Policies for a more resilient single financial and capital market will be more crucial than ever in steering the effects of a massive recovery plan.

Past and planned policy efforts require close follow-up in terms of implementation across the 27 Member States. Guidance under the new European Semester arrangements will play an important role in this respect. However, enforcement of EU law also remains crucial in protecting and fostering capital movement and freedom of payments.

A whole **new scenario** is unfolding in trans-Atlantic relations. At the same time, China's response to the pandemic has already accelerated economic recovery in that part of the world. Continuing to combine the EU's traditional openness to foreign capital flows with its efforts to prevent unfair and abusive practices remains crucial, as well as pursuing its digital agenda while safeguarding its technological leadership.

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[141] Council Regulation (EC) No 2271/96 of 22 November 1996 protecting against the effects of the extra-territorial application of legislation adopted by a third country, and actions based thereon or resulting therefrom (OJ L 309, 29.11.1996, p. 1).

[142] Guidance Note — Questions and Answers: adoption of update of the Blocking Statute (OJ C 277I, 7.8.2018, p. 4, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.CI.2018.277.01.0004.01.ENG&toc=OJ:C:2018:277I:TOC.

In this context, **digital finance** plays an important role in favouring capital movement and freedom of payments. Embracing digital finance and increasing digital finance awareness will create the basis for a more competitive, resilient and inclusive financial system. Proper governance in this field, within the right (regulatory and supervisory) frameworks to leverage new technologies while avoiding the misuse of these new technologies, will continue to be a key objective for the EU in the years to come.