LEGISLATION KEY MILESTONES OF CAPITAL MARKET UNION IN THE REPUBLIC OF CROATIA AND THE EUROPEAN UNION

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ABSTRACT
The paper presents an overview of the European Union legal framework related to capital markets, investment funds, credit rating agencies, securitization subjects and structures, primary and secondary markets' actors and mechanisms, venture capital, social entrepreneurship and long-term investment funds. It also deals with short selling, benchmarks and prospectuses. The content of the paper is defined by the scope of activities of the European Securities and Markets Authority (its supervised entities and the scope of its prudential activities), the consequences of the 2008-2009 financial crisis, and the promises to reshape and develop financial markets and instruments in the European Union and Croatia. The paper intentionally excludes major players in the financial markets in Europe, such as credit institutions, pension funds, insurance undertakings, factoring and leasing companies.

The above-mentioned elements are all key points of the strategic project of a Capital Market Union in the EU with the main goals of promoting non-banking financial services to entrepreneurs and SMEs, introducing and developing an alternative to banking loans and other traditional financing tools. These rules and regulations, colloquially called single rulebook, are also applied in the Republic of Croatia as a member of the European Union. Finally, an overview of the evolution of financial markets regulation and supervision infrastructure in Croatia starting since 1990 up to today is provided, including the laws transposing the above-mentioned EU directives.

The descriptive methodology, detailed analysis, critical resume and synthesis of all the researched elements are used to approach the different levels of rules necessary for future development of financial markets and instruments in Croatia and the EU. The hypothesis tested is whether the new regulatory framework achieves its goals of promoting non-conventional financial instruments in Europe and supporting economic growth.

Keywords: Capital Market Union, financial market, ESMA, financial instruments, market abuse, securitization
1. INTRODUCTION

The current capital markets’ legislative framework in the EU consists of an extensive set of acts covering multiple aspects of capital markets. The establishment of a single market is at the root of the legislation dating back to the 1980s. A major regulatory overhaul was undertaken during the last decade after the financial crisis of 2008-2009 brought to surface a series of flaws in the financial system that were previously overlooked or underestimated. The purpose of this regulatory reform, coordinated at a global level,1 was to increase the robustness and resilience of the capital markets and to restore investors’ confidence through more efficient regulation and supervision of integrated financial markets, privation of regulatory arbitrage and promotion of more competence on the market. The crisis also led to the creation of the European system of financial supervision (ESFS) in 2011 consisting of three European supervisory authorities (ESMA, EBA and EIOPA) and a board to monitor systemic risks (ESRB).2 The mission of the European Securities and Markets Authority (ESMA) is to protect investors and promote orderly markets and financial stability. It achieves this by: “assessing risks to investors, markets and financial stability, completing a single rulebook for EU financial markets, promoting supervisory convergence and directly supervising credit rating agencies and trade repositories.”3 The goals of the European Commission are stronger financial markets supporting investments in the European Union. The European Commission aims at completing the Capital Markets Union till the end of 2019 through three main directions: a European licence for European products, harmonized and more simple rules for deeper financial markets, and more consistent and efficient supervision.

1 Leaders’ Statement, the Pittsburgh Summit, September 24-25 2009, p. 2 [https://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf] Accessed 30 January 2019
2 [https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/european-system-financial-supervision_en] Accessed 1 February 2019
3 [https://www.esma.europa.eu/about-esma/who-we-are] and [https://www.esma.europa.eu/rules-databases-library/interactive-single-rulebook-isrb] Accessed 1 February 2019. Official sources of EU legislation is Official Journal of the European Union but also ESMA Interactive Single Rulebook is an on-line tool that aims at providing a comprehensive overview of and easy access to all level 2 and level 3 measures adopted in relation to a given level 1 text in the field of securities markets. Relevant tags signal the existence of Implementing (“IA”) or Delegated Acts (“DA”) adopted by the European Commission (including Technical Standards developed by ESMA and endorsed by the European Commission: “RTS” or “TTS”), as well as Guidelines (“GL”), Opinions (“OP”) and Q&As (“Q&As”) issued by ESMA.
2.1. Markets in financial instruments

Directive 2014/65/EU\(^4\) (MIFID II) is the cornerstone piece of regulation related to capital markets. It broadened the scope of Directive 2004/39/EC\(^5\) (MIFID) and brought new provisions adapted to contemporary developments. MIFID II defines the scope of its application\(^6\) and lays down the list of services, activities and instruments to which it applies.\(^7\) It also establishes operating requirements applicable to investment firms, regulated markets and data reporting service providers. MIFID II has been transposed into the Croatian Law on capital market.\(^8\)

In addition to horizontal organisational requirements applicable across the financial services industry, MIFID II brings specific provisions related to algorithmic trading.\(^9\) These provisions, together with new provisions introducing the requirement for regulated markets to have in place resilient systems capable of operating under conditions of severe market stress,\(^10\) demonstrate how the legislation is adapting to technological innovation and increased systemic risk. Concern for mitigating systemic risk is also demonstrated in Title IV where a set of rules has been introduced, imposing limits, controls and reporting requirements in relation to commodity derivatives trading. In a similar vein, rules are imposed upon multilateral trading facilities (MTFs) and organised trading facilities (OTFs) with the aim of increasing the level of transparency and orderliness in transactions taking place outside of the regulated markets.\(^11\) By doing so, such rules bring MTFs and OTFs closer to the transparency level required from regulated markets. The introduction of data reporting service providers with the purpose of collecting, consolidating, reporting and publishing information about transactions in financial instruments at the EU level are completing this purpose.\(^12\)

Finally, emphasis is put on provision of adequate and timely information, procedures assessing suitability and appropriateness of services to individual clients, or-

\(^4\) Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ L 173/349 (MIFID II)

\(^5\) Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] OJ L 145.

\(^6\) MIFID II, art. 1-3

\(^7\) MIFID II, Annex I

\(^8\) Law on capital market, Official Gazette of the Republic of Croatia No. 65/18

\(^9\) MIFID II, art. 17

\(^10\) MIFID II, art. 48

\(^11\) MIFID II, art. 18-20 and 31-33

\(^12\) MIFID II, art. 59-66
der handling and execution rules, and record of all services, activities and transactions undertaken. Important modifications brought by MIFID II in the area of consumer protection include the introduction of the products approval process and specific requirements for independent financial advisers. The purpose of the product approval process is to avoid misselling by specifying target markets in advance and ensuring that all relevant risks are assessed.

MIFID II is supplemented by four delegated acts (DAs), five implementing acts (IAs), eleven implementing technical standards (ITS), and nineteen regulatory technical standards (RTS). These numerous second level legislative acts leaves little room for divergent implementation of the directive and reflect the will to regulate in detail activities on capital markets.

MIFID II is also supplemented by Regulation (EU) No 600/2014 on markets in financial instruments (MIFIR). MIFIR is a very technical regulation setting forth transparency requirements for trading venues and OTC trading in financial instruments. MIFIR also brings an important innovation in the supervisory powers of ESMA, EBA and national competent authorities by granting them the power to restrict (where certain conditions are fulfilled), the sale of certain financial products or certain activities or practices. Corresponding product intervention powers have been granted to EIOPA and national competent authorities in relation to insurance-based investment products in the PRIIPs Regulation. MIFIR is supplemented by seventeen RTS.

Regulation (EU) No 648/2012 (EMIR) is a direct consequence of the 2008-2009 financial crisis after which it became apparent that the complexity of interdependencies and related risks created by OTC derivatives required regulatory intervention. The speculative nature and lack of transparency of derivatives before the crisis pushed the regulation towards the adoption of rules aimed at managing systemic risk, bringing more standardization and transparency in their use.

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13 MIFID II, art. 25-28
14 MIFID II, art. 16 and art. 23
15 MIFID II, art. 16(3) and art. 24
16 Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) 648/2012 [2014] OJ L 173/84 (MIFIR)
17 MIFIR, art. 40-42
18 Regulation (EU) No 1286/2014 of the European Parliament and of the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs) [2014] OJ L 352/1, Chapter III
19 Regulation (EU) No 648/2012 of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories OJ L 201/1 (EMIR)
20 EMIR, recital par. (4)
and trading and improving investor safety. In line with the agreement reached at the 2009 G20 meeting in Pittsburgh, EMIR introduced risk management techniques such as clearing or bilateral collateral management for over-the-counter (OTC) derivative contracts, reporting to trade repositories and operational and organisational requirements applicable to central counterparties (CCPs) and trade repositories. EMIR is supplemented by six DAs, twenty-five RTS, twenty-two IAs and five ITS. Central securities depositories (CSDs) and CCPs are key elements of the post-trade market infrastructure. Together, they help maintaining participants’ confidence that transactions will be executed within agreed terms and conditions. Regulation (EU) No 909/2014\(^2\) (CSDR) is aligning rules applicable to CSDs and securities settlement with international principles for financial market infrastructures.\(^3\) The purpose of these principles and rules is to minimise risks of disruption in settlement systems, to ensure common prudential rules necessary to mitigate risks stemming from an increasing number of cross-border settlements, and to promote an open internal market.\(^4\) The CSDR is supplemented by one DA, four RTS and two ITS.

Several other regulations related to markets in financial instruments need to be mentioned. Among them, Regulation (EU) 2016/1011\(^5\) introduces authorisation and supervision of benchmark administrators and rules related to the calculation and publication of benchmarks used in the financial industry. This regulatory attempt to rein in conflicts of interest related to benchmarks is a direct reaction to cases of manipulation, the most infamous being the LIBOR scandal.\(^6\) In a similar vein, Regulation (EU) No 236/2012\(^7\) is the regulatory answer to systemic risks unveiled by the 2008-2009 financial crisis. This Regulation introduces transparency rules on net short positions, restrictions on uncovered short sales and powers of intervention of competent authorities and ESMA in exceptional circumstances.

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\(^2\) Regulation (EU) No 909/2014 of the European Parliament and of the Council on improving securities settlement in the European Union and on central securities depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No 236/2012 [2014] OJ L 257/1 (CSDR)

\(^3\) Principles for Financial Market Infrastructures. BIS and IOSCO. April 2012

\(^4\) Regulation (EU) 2016/1011 of the European Parliament and of the Council on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds and amending Directives 2008/48/EC and 2014/17/EU and Regulation (EU) No 596/2014 [2016] OJ L 171/1

\(^5\) Rose, C.S., Sesia A., *Barclays and the LIBOR Scandal*, Harvard Business School Case 313-075, January 2013. (Revised October 2014)

\(^6\) Regulation (EU) No 236/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps [2012] OJ L 86/1
2.2. Transparency and market abuse

Information provided to the public by the issuers of financial instruments is vital to investors’ confidence and markets’ functioning. As a rule, securities offered to the public or admitted to trading on a regulated market have to be accompanied by a prospectus. In addition, there is also an ongoing obligation to continue disclosing information relevant to investors.

Matters related to prospectuses are regulated by Regulation (EU) 2017/1129\(^\text{27}\) (Prospectus Regulation). The aim of the Prospectus Regulation is to protect investors, achieve market efficiency by imposing rules on disclosure of information, and support the internal market for capital through a harmonised framework at EU level.\(^\text{28}\) The Prospectus Regulation lays down in great detail the form and content of the prospectus, describes the process of its approval and publication, and defines specific rules in relation to issuers established in third countries. At the same time, the Prospectus Regulation is offering many exemptions aimed at reducing the administrative burden in specific situations that do not require the highest level of investor protection.\(^\text{29}\) In line with the CMU initiative, it also introduced a lighter disclosure regime for SMEs\(^\text{30}\) aligned with provisions from MIFID II.\(^\text{31}\) The Commission has not yet adopted delegated or implementing acts related to the Prospectus Regulation.

Directive 2004/109/EC\(^\text{32}\) (Transparency Directive) applies to securities admitted to trading on a regulated market. It imposes disclosure requirements regarding periodic (annual financial reports, half-yearly financial reports, etc.) and ongoing information (acquisition or disposal of major holdings, changes in the rights attached to financial instruments). It also determines how the information shall be conveyed to the public. The Transparency Directive is supplemented by three DAs, two IAs and one RTS. The Transparency Directive has been transposed into the current Croatian Law on capital market.

\(^{27}\) Regulation (EU) 2017/1129 of the European Parliament and of the Council 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 [2017] OJ L 16/12 (Prospectus Regulation)

\(^{28}\) Prospectus Regulation, recital, pars (3) and (7)

\(^{29}\) Prospectus Regulation, art. 1 and art. 3

\(^{30}\) Prospectus Regulation, art. 15

\(^{31}\) MIFID II, art. 33

\(^{32}\) Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC [2004] OJ L 390/38
Finally, Regulation (EU) No 596/2014 on market abuse (MAR) provides for a uniform framework related to insider dealing, unlawful disclosure of inside information and market manipulation. MAR broadens the scope of regulation to MTFs, OTFs and financial instruments such as credit default swaps and contracts for difference. It also puts down detailed rules for public disclosure of inside information, the administration of insider lists, reporting of managers’ transactions, market soundings, investment recommendations and statistics and disclosure or dissemination of information in the media. MAR is supplemented by one IA, six RTS and six ITS.

2.3. Investment funds

Investment funds in the EU are regulated by two directives and three regulations. Directive 2009/65/EC and Directive 2014/91/EU amending it, together form the so called UCITS Directive. Separately, Directive 2009/65/EC is referred to as UCITS IV, while Directive 2014/91/EU, introducing specific provisions related to remuneration policies and depositaries, is called UCITS V. The UCITS Directive has been transposed into the Croatian Law on open-ended investment funds with public offer. For the purpose of the UCITS Directive, UCITS means an undertaking “(a) with the sole object of collective investment in transferable securities or in other liquid financial assets … of capital raised from the public and which operate on the principle of risk-spreading; and (b) with units which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of those undertakings’ assets.” Those key elements are differentiating UCITS from alternative investment funds.

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33 Regulation (EU) No 596/2014 of the European Parliament and of the Council on market abuse (market abuse regulation) and repealing Directive 2003/6/EC of the European Parliament and of the Council and Commission Directives 2003/124/EC, 2003/125/EC and 2004/72/EC [2014] OJ L 173/1 (MAR)
34 MAR, art. 2
35 Directive 2009/65/EC of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [2009] OJ L 302/32 (UCITS Directive)
36 Directive 2014/91/EU of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions [2014] OJ L 257/186
37 Law on open-ended investment funds with public offer, Official Gazette of the Republic of Croatia No. 44/16.
38 UCITS Directive, art. 1(2)
Alternative investment funds (AIFs), regulated by Directive 2011/61/EU (AIFMD) are such collective investment undertakings which “(i) raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) do not require authorisation pursuant to” the UCITS Directive. However, allowing for the fact that the stringent conditions from the AIFMD need not to apply to smaller fund managers, the AIFMD introduces thresholds applicable to total assets under management and allowing operations under a lighter regime. The AIFMD has been transposed into the Croatian Law on alternative investment funds.

The goal of the UCITS Directive is to facilitate cross-border offerings of investment funds to retail investors. Having in focus consumer protection, it deals in great detail with both the management companies and the UCITS. On the other hand, the AIFMD deals primarily with management companies. This can be explained by the diversity of investment strategies in the alternative funds realm and regulatory will, in the aftermath of the 2008-2009 financial crisis, to set up a framework ensuring at least minimum organisational standards and reporting obligations in a sector which was traditionally very lightly regulated.

The UCITS Directive and the AIFMD lay down general requirements in line with the usual structure of legislative acts dealing with financial services. In addition, both directives include obligations regarding the depositary of the funds. The UCITS Directive also deals with some specific issues in the context of cross-border activities (mergers of UCITS and master-feeder structures). Unlike the AIFMD, the UCITS Directive deals in great detail with obligations concerning the investment policies of UCITS, including acceptable investment instruments and investment limits. The UCITS Directive is supplemented by five DAs and two ITS, whilst four DAs, one RTS and four IAs supplement the AIFMD.

It is important to note that units in collective investment undertakings are considered to be financial instruments according to Annex I, Section C, of MIFID II. This provision means that MIFID II, in particular its provisions related to distribution by investment firms, apply to units and shares in investment funds.

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39 Directive 2011/61/EU of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [2011] OJ L 174/1 (AIFMD)
40 See AIFMD, Art. 4(1)(a)
41 Law on alternative investment funds, Official Gazette of the Republic of Croatia No. 21/18
42 UCITS Directive, art. 37-48 and art. 58-67
43 UCITS Directive, art. 49-57 and art. 83-90
Regulations (EU) No 345/2013,44 (EU) No 346/201345 and (EU) 2015/760,46 lay down rules for fund managers that apply specific investment strategies and wish to use the EuSef, EuVECA and ELTIF designations in relation to the marketing of such funds. The regulations set down uniform rules for both fund managers exempt from AIFMD requirements and for fund managers fully authorised under the AIFMD. They can be seen as a vehicle for the facilitation of fund-raising in three under-represented niche investment strategies which are stated as a priority in the CMU initiative.

2.4. Structured products regulatory frame

The European Commission aftermath the financial crisis wanted to revitalize the securitisation market in the EU, in order to offer new financing tools, especially for small and medium-sized enterprises and other deficitary subjects. “Securitisation frame initiative” is initialised in form of a proposed regulation in 2015, should establish a new framework for “simple, transparent, and standardised (STS) securitisations” which have direct implications for the overall prudential framework for credit institutions and investment firms, after what it is need to redefine amendments on the Capital Requirements Regulation (EU) No 575/201347. Amendments have aims to adjust risk retention profiles to reflect a new risk calculation methods and rates and, consequently capital requirements for new tranches. New rules for simple, transparent and standardised securitisation adopted by the co-legislators in 2017 should supply wider investment opportunities and intensive lending to Europe’s businesses subjects. Also promotion of covered bonds as a source of funding for banks, thereby have to increase lending to the economy while protecting consumers and investors on the other hand.48

44 Regulation (EU) No 345/2013 of the European Parliament and of the Council on European venture capital funds [2013] OJ L 115/1
45 Regulation (EU) No 346/2013 of the European Parliament and of the Council on European social entrepreneurship funds [2013] OJ L 115/18
46 Regulation (EU) 2015/760 of the European Parliament and of the Council on European long-term investment funds [2015] OJ L 123/98
47 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 Text with EEA relevance L 176/1
48 According to 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 L347/35 and Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms L 347/1
The CRR (Regulation (EU) 2013/575), covers standardised rules for credit institutions and investment firms concerning general prudential requirements regarding capital connected to exposures to credit risk, market risk, operational risk and settlement risk. International standards on bank capital adequacy through Basel standards provisions were transposed into EU law through Capital Requirements Directive, CRD (2013/36/EU) and the Capital Requirements Regulation, CRR (575/2013). This current “CRR Regulation” became effective from the first of January 2014 and replace Capital Requirements Directives (2006/48/EC and 2006/49/EC). The Regulation is supplemented by two Commission Delegated Acts, four Commission Implementing Acts, Regulatory technical Standards (RTS), and Implementing Technical Standards (ITS). While CRD IV governs access to deposit-taking activities, the CRR establishes the prudential requirements that institutions are obligated to. Developments at global level lead to the need to adjust EU legislation consequently to Commission’s securitisation proposal directed to amendments to the CRR.49

Capital requirements for securitization exposures, including the more risk-sensitive treatment for STS securitizations, are set out in the CRR proposal, while STS eligibility criteria, due diligence and disclosure requirements, previously accompanied in Part V of CRR, were removed to the new securitization frame. The new Articles from 254 to 270a, coordinated with the revised BCBS framework, implement a new range of applicable approaches for the calculation of risk-weighted assets. Securitization Internal Ratings-Based Approach is the primary credit risk calculation approaches with KIRB information as a key input. An institution that cannot calculate KIRB for a given securitization position have the External Ratings-Based Approach (SEC-ERBA) for the calculation of the risk-weighted exposure amounts.

Covered bonds as one of financial structured products are a long-term finance tool in some EU countries for public sector entities and property market. It is issued mainly by credit institutions. Primary benefit is double-recourse protection to bondholders: the bondholder has a direct and preferential claim against assets if the issuer fails and an ordinary claim against the issuer’s remaining assets. It is a huge heterogeneity on this market in Europe now and this fragmentation need standardization in underwriting and disclosure practices and form the field for more deeper, liquid and accessible markets across Europe. This is also Capital Market Union action plan segment. In March 2018, the Commission proposed a

49 Regulation (EU) No 600/2014 of the European Parliament and of the Council on markets in financial instruments and amending Regulation (EU) 648/2012 [2014] OJ L 173/84
dedicated EU framework for covered bonds, consisting of a directive and a regulation.\textsuperscript{50}

There is no formal, universally accepted definition of covered bonds, but three characteristics are considered to define them: dual recourse mechanism; asset segregation and dynamic cover pool; and strict legal and supervisory frameworks. They are regulated mainly at national level. At EU level, there is no single, harmonised legal framework for covered bonds, and the legislation relating to them is interwoven in the provisions of different regulations and directives. Due to their features, covered bonds are considered a low-risk debt instrument, therefore banks investing in them do not have to set aside as much regulatory capital as when they invest in other assets, and covered bonds has privileged preferential prudential and regulatory treatment.

Against this background, the European Commission is proposing an EU legislative framework for covered bonds. The proposal is based on the European Banking Authority’s (EBA) 2014 and 2016 reports the latter advocating legislative action to standardize covered bonds at EU level. The European Parliament’s resolution of June 2017 on covered bonds supported their integration at EU level. The enabling framework for covered bonds was included in the 2018 Commission work programme (CWP) under the new initiatives aimed at completing the Capital Markets Union (CMU).\textsuperscript{51}

2.5. Credit ratings and capital markets landscape

The CRA Regulation (EC) 1060/2009 was introduced in 2009\textsuperscript{52} in European Union and was amended by Regulation (EU) 513/2011 in 2011\textsuperscript{53} and Regulation

\textsuperscript{50} Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Capital Markets Union; time for renewed efforts to deliver for investment, growth and a stronger role of the euro, Brussels, 2018, COM/2018/767 final [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0767] Accessed 1 February 2019

\textsuperscript{51} Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Capital Markets Union; time for renewed efforts to deliver for investment, growth and a stronger role of the euro, Brussels, 2018, COM/2018/767 final [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0767] Accessed 1 February 2019

\textsuperscript{52} Regulation (EC) No 1060/2009 of the of the European Parliament and of the Council on credit rating agencies (CRA), [2015] OJ L 302

\textsuperscript{53} Regulation (EU) No 513/2011 of the of the European Parliament and of the Council amending Regulation (EC) No 1060/2009 on credit rating agencies [2011] OJ L 145/30.
(EU) 462/2013 in 2013\textsuperscript{54} with the mission of a common approach to the regulation and supervision of credit rating agencies within the European Union, and also independence and quality of rating activities, resulted scores and high levels of investor protection. Regulation creates a common governance framework for credit rating agencies and the use of credit ratings on financial markets.

Regulation (EC) 1060/2009 introduces a common regulatory approach in order to promote the integrity, transparency, responsibility, good governance and reliability of credit rating activities, supporting the quality of credit ratings issued in the European Union. Also achieving a high level of consumer and investor protection is in focus. It covers also conditions for the issuing of credit ratings and rules on the organization and conduct of credit rating agencies to promote independence of ratings and the avoidance of conflicts of interest.\textsuperscript{55} A credit rating agencies should be licenced under this Regulation and also be recognised as an External Credit Assessment Institution (ECAI).\textsuperscript{56} Regulation contains definition and use credit ratings, issuing of credit ratings, independence and avoidance of conflicts of interest, methodologies, models and key rating assumptions, disclosure and presentation of credit ratings. Also it had included registration procedure and supervision fees, competent authorities and supervisory measures, coordination of authorities, exchange of information, etc.\textsuperscript{57}

Amending regulation (EU) 513/2011 recommended that the three new European Supervisory Authorities with a network of national financial supervisors cooperate efficiently. The ESFS should be aimed at upgrading the quality and consistency of national supervision, strengthening oversight of cross-border groups through the setting up of supervisory colleges and establishing a European single rule book applicable to all financial market participants in the internal market, including credit rating agencies. ESMA should be exclusively responsible for the registration and supervision of credit rating agencies in the Union, while specific tasks can be delegated to competent authorities. Transparency standards are higher to meet the public interest and investors protection.\textsuperscript{58}

Amending Regulation complements, the current regulatory framework for credit rating agencies. Some of the most important new issues is better solutions for is-

\textsuperscript{54} Regulation (EU) No 462/2013 amending Regulation (EC) of the of the European Parliament and of the Council No 1060/2009 on credit rating agencies [2013] OJ L 146/1.
\textsuperscript{55} CRA, art. 1.
\textsuperscript{56} CRA, art. 2., Directive 2006/48/EC.
\textsuperscript{57} CRA, art. 3-10.
\textsuperscript{58} European Securities and Markets Authority (ESMA), [https://www.esma.europa.eu/about-esma/who-we-are] Accessed 1 February 2019.
suer - pays model and information disclosure for structured finance instruments. Reasons to transparency, procedural requirements and the timing of publication standards revision specifically for sovereign ratings was consequence of sovereign debt crisis. The data on the probability of default of credit ratings and rating outlooks based on historical performance will be published on the central repository created by ESMA and it will support future investment decisions.  

ESMA has published its Final Report on draft Regulatory Technical Standards (RTS) in 2014 required under the Credit Rating Agencies (CRA3) Regulation regarding information on transparency of structured finance instruments, the European Rating Platform and periodic reporting of charged fees. This Regulation also lays down obligations for issuers, originators and sponsors established in the Union regarding structured finance instruments.

In order to increase market competition on a market that has been dominated by three subjects, measures should be taken to encourage the use of smaller credit rating agencies. If it is necessary to seek credit ratings from two or more credit rating agencies the issuer or a related third party should consider choosing at least one credit rating agency with smaller relative significance on the market. The Final Report on three draft RTSs under the CRA 3 Regulation, requires ESMA to develop a drafts RTS specifying the information that the issuer, originator and sponsor of a structured finance instrument must disclose; the frequency of information updating and the standardised presentation of the information. The CRA regulatory frame is supplemented by two Delegated Acts (DAs), ten Regulatory Technical Standards (RTSs) and seven Implemented Technical Standards (ITSs).

Also CRA Regulation requires ESMA to develop a draft RTS concerning the report content and the structure, including structure, format, method and timing of. It is also need to develop a draft RTS to specify fees charged by credit rating agencies for the purpose of on-going supervision by ESMA.

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59 ESMA/2014/685
60 European Securities and Markets Authority (ESMA), [https://www.esma.europa.eu/about-esma/who-we-are] Accessed 1 February 2019
61 Regulation (EU) No 462/2013, Article 8b (3)
62 Regulation (EU) No 462/2013, Article 21(4a)(a)
63 Regulation (EU) No 462/2013, Article 21(4a)(b)
2.6. **Capital markets union building blocks and Croatian financial market structure**

The strengthening of the role of capital markets in the European union face several challenges such as over-reliance on banks, differences in financial conditions, rules and practices among member states, and limited financial resources available to small and medium-sized businesses (enterprises). It is on these basic assumptions that the European Commission formulated its prerequisites for the strengthening of financial markets and the creation of a capital markets union. The political guidelines were disclosed in the Green Paper on EU capital markets in January 2015, in parallel to the banking union.64

The Action Plan was adopted in 2015, and the implementation of measures is expected by the end of 2019. Implementation faces obstacles and inertia due to various factors, among others various crises, major economic and political overhauls in priorities of the European policy, but also heterogeneity in the level of development of financial markets in the European Union. Building Capital Markets Union is part of the third step of the European Commission and so called Juncker’s plan to improve the investment environment.

Proposed measures include 33 different areas: innovation, start-ups and unlisted companies; opportunities to increase capital collected from the public; investments in long-term infrastructure projects and sustainable investment; encouraging investment by retail investors; increasing the capacity of the capital market and encouraging international investment. Difficulties in the implementation of measures can already be seen, in large part due to indirect factors such as heterogeneous bankruptcy rules, supervisory practices, tax regimes, the status of Brexit etc. Capital Union in the EU is based on an established framework for the banking sector and its credit potential which is formalized through the three pillars of the banking union.65

The theory of financial intermediation is based on the assumption that the market size is positively correlated with the ability of the market to mobilize capital and diversify risk, and indicators of market activity (turnover in relation to GDP is the best indicator of market development). Although the scale of financial intermediation with the support of financial markets and traditional and modern financial instruments is at a low level of development in Europe, the European Union has

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64 Pavković, A., *Small and medium sized enterprises financing*, in: Competitiveness and European Integration, International Scientific Conference, Cluj-Napoca, Romania, October 2007, pp. 26-27

65 Pavković, A., *Bankovna unija: conditio sine qua non financijske i fiskalne stabilnosti Europe*, Interna revizija i kontrola, HZRFD, 18. Savjetovanje, Opatija, 2015., pp. 91.-109
invested significant efforts in its development, while preserving financial stability. However, different European countries are divergently developed. For example, the market capitalization of the stock market in the UK stood at 120% of GDP, in the Netherlands 98%, while in Lithuania, Latvia, Cyprus amounted to less than 10%.66

Unlike countries with developed financial markets, the ratio of the domestic equity market capitalization of the national GDP in markets comparable to the Croatian financial market for the year 2012 were as follows: on the Warsaw Stock Exchange, 37.7%, 27.1% Vienna, Budapest, 16.1%, 14.3% Ljubljana. Market equity securities in the Republic of Croatia are still relatively undeveloped, which is particularly evident by observing the market capitalization of the comparable markets.

The latest wave of reform is motivated by the “Capital Markets Union” (CMU) political initiative from 2015, which is focused on employment and economic growth. Most of the action plan is focused on shifting financial intermediation towards capital markets, in particular with respect to small and medium-sized companies, and further breaking down barriers that are blocking cross-border investments and competition in financial services. Other goals include ensuring regulatory support to infrastructure financing and enhancing the capacity of banks to lend. The action plan consists of 13 legislative proposals67 out of which three have been adopted till the beginning of 2019: the Prospectus Regulation, the revision of the EUSEF and EUVECA regulations, and the STS Regulation on securitisations.68

Generally, legislative acts related to financial regulation have in common a section stipulating provisions regarding the authorisation of service providers. They also contain organisational requirements with a focus on internal control mechanisms, conflict of interests and delegation of functions to third parties. Provisions related

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66 Ibid.

67 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Action Plan on Building a Capital Markets Union, Brussels, 2015, COM/2015/468 final, pp.3-6 [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52015DC04 68] Accessed 1 February 2019

68 Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Capital Markets Union; time for renewed efforts to deliver for investment, growth and a stronger role of the euro, Brussels, 2018, COM/2018/767 final, p.3 [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0767] Accessed 1 February 2019
to the freedom of establishment and provide services within the EU and rules applying to providers from third countries are also given. Finally, there is a section laying down the supervisory powers and duties of cooperation of competent authorities. Such common features are aimed at ensuring the efficient functioning of the internal market and creating an area at the EU level. A noticeable legislative trend is the use of regulations instead of directives. The recitals of the regulations explain this trend by the need to create a true single market unhampered by costs and complexity created by local interpretations of the directives.

It is generally considered that the small and medium enterprises are an important part of both developed and developing economies and at the same time are a major source of innovation, creativity and new jobs. Entrepreneurial activity supports the economic development of each country and, consequently, is an important part of every national economy where it should be encouraged, not only with public funds, but also with the market founded mechanisms of the financial markets. Often such subjects are deficient in terms of new sources for business and miss the new investment opportunities because of these restrictions.

After the 1990-is when Croatia became independent there was a need to implement new rules in the financial sector. In that time, market based instruments were not present and in Croatia only banks’ loans were available funds. First, the Law on issuing and trading of securities was passed in 1995. Its second iteration was the Law on securities’ markets from 2002, which was amended in 2006. Also in 2005 HANFA was founded, the body for supervision of financial market participants and instruments in Croatia as a regulatory and supervisory body for non-banking institutions and financial markets in Croatia. HANFA operates according to the Law on the Croatian Agency for Supervision of Financial Services.

The Law on capital market was introduced in 2008 and was amended seven times after that till the current Law. During that time, stricter rules were implemented tightening sanctions and penalties. Main reasons and motives to change that law are new rules about prudential standards of credit institutions and investments firms in European Union, ESMA and ESRB roles in new EU institutional

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69 Pavković, op. cit. note 64, pp. 26-27. The paper proposed a new model market-based for financing small and medium-sized companies, without relying on budgetary funds and applying claims from securitization.

70 Official Gazette of the Republic of Croatia No. 107/95

71 Official Gazette of the Republic of Croatia No. 84/02 and No. 138/06

72 Official Gazette of the Republic of Croatia No. 140/05

73 Law on capital market, Official Gazette of the Republic of Croatia No. 88/08

74 Official Gazette of the Republic of Croatia No. 146/08, 74/09, 54/13, 159/13, 18/15, 110/15, 54/13
framework, governance system and prerequisites on management and supervisory boards members, risk management, compliance standards, close links, investments companies’ exposures, multilateral trading platform, reporting, regulatory capital, capital requirements, bonus schemes, disclosure standards, etc. These set of rules are more complex than the previous laid down by MiFID I. Numerous additional sub acts are implemented as a frame for mentioned areas, and also mechanism of investor protection become stronger. Also consequential principles are stronger investor protection, new places for trading and introduction of derivatives into trading. Importantly the base set of rules for credit institutions and investments firms prudential standards are determined and regulated 2013 but also Regulation in order to establish a European deposit insurance system and Directive from 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms. Current Law on financial market implemented in 2018 transposed 15 directives and 9 regulations (MiFID II is most important).75

New trading venues are introduced alongside regulated markets and multilateral trading platforms as older systems, as well as a new platform for SME financing, new costs and reports for ESMA, investor protection rules, transparency rules, measures for market abuse and insider trading. In near time in Croatia should licence subjects for clearing and settlement with financial instruments post trading like in other countries. At EU level estimations are that one-time cost of implementation of these directives and regulations have to be between 500 to 700 million euros, and that the annual costs stand at between 250 and 500 million euros.76

3. CONCLUDING REMARKS

European financial systems are mainly bank centric and loan oriented. The same situation is in Croatia. In the aftermath of the financial crisis in the USA, the spill over to Europe and culmination in serious consequences in all economy, other obstacles also stopped the intensive recovery of the economy. Also with the aim to more integrated financial system in EU which should be competitive to USA, banking union is in force and in parallel Europe is trying to promote capital market union. In that sense primary goals are to promote innovative finance tools, develop SMEs as a key instrument of GDP growth, to reach financial instrument

75 Regulation (EU) No. 575/2013 of European Parliament and European Council of June 26 2013. on prudential requirements for credit institutions and investment firms and amended Regulation (EU) No. 648/2012 and Regulation (EU) No. 806/2014 Directive No. 2014/59/EU

76 European Securities and Markets Authority (ESMA) [https://www.esma.europa.eu/about-esma/who-we-are] Accessed 1 February 2019
structures and to move from bank loans to other instruments. Also new investment opportunities for institutional and individual investors are needed. European and Croatian financial systems should be transformed from deposit-taking model into stakeholders who use derivatives, structured products, other debt and equity instruments, etc. as a financing tool or risk transfer instruments. However, today's facts and historical practice suggest that the development and transformation will probably be slow because on Croatian market there is a trading with a dozen liquid equity issues and volume is about ten times smaller than in 2008. In Croatia it is expected increase in capital market transactions but not significantly because of different mentioned reasons, but otherwise it can produce synergy other positive effects on homogeneity, comparability, transferability of rights and solving other problems in economy and jurisdiction. Market for bonds is growing but other markets are not barely alive. Despite attempts to develop financial markets and instruments, there are obstacles which determine the European future like Brexit and FinTech, importance of London as financial centre and United Kingdom which accounts for 40 to 80 % of financial transactions in the European Union.

The main objectives of establishing a Capital Markets Union are: 1) diversify financial system complementary to bank financing deeper capital markets, 2) to activate the capital from all over Europe and transfer it into the economy within and outside Europe, and more investment chances in Europe, 3) to create a single capital market investors and financially deficient subjects from different sources and regardless of geographical origin. The benefits of EU capital markets should be exercised by citizens (greater availability and transparency of investment products or such longer forms of saving for retirement), businesses (start-ups and companies have easier access to cheaper capital), investors (more long-term investment opportunities), banks (healthy balance and credit possibilities, for example the wider application of securitization). It will also enable the more efficient supervision of financial markets and financial stability. Important elements of development are new rules on covered bonds that will become cheaper sources of banks especially in the less developed countries as well as easier distribution of investment funds outside national borders. In addition, it should have simplified cross-border transactions of receivables, which will resolve the present problems when the national laws and specific conflict are present. Capital Markets Union is complementary to banking union institute, not its substitute and should upgrade the framework of operations of financial institutions and markets. The Union could also improve monetary transmission mechanism of the development of market-based benchmark interest rates that are not directly related to the banking business. In addition, it would be easier to solve local crises and to access foreign capital and
potential securitization instruments reduce the pressure on bank financing and contribute to the well-functioning of the interbank market.\footnote{Op.cit., str. 111.}

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