Politics and Policy 2016

Global Counsel

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Introduction

As ever, this will be a year in which the landscape for businesses and investors in the EU will be shaped by the choices of politicians and policymakers.

It will be a year in which identity politics, euroscepticism and external instability will strain the EU's basic structure, dictate the future of the single currency – and could see Britain choose to leave the Union altogether.

It will be a year of important shifts in the regulation of energy, financial services and technology businesses. Conflicting political aims around the regulation of competition, carbon and corporate responsibility will all need careful navigation. The Europeanisation of Europe's banks, energy businesses and capital markets will all come up against political resistance, and the scope for European consolidation in sectors like telecoms will be fiercely contested.

It will be a year in which the way we regulate technology businesses will evolve again. From political judgements of the risks and opportunities of the 'gig economy' to the regulation and protection of data, the scope for innovation is changing and policymakers are often balancing competing imperatives around privacy and security and disruption and continuity.

To start the year, the GC London team have previewed some of these European choices, and why they will matter.

Stephen Adams

In 2016 Beata Szydlo's will be just one of a crowded field of Euro-scepticisms.

Euroscepticisms

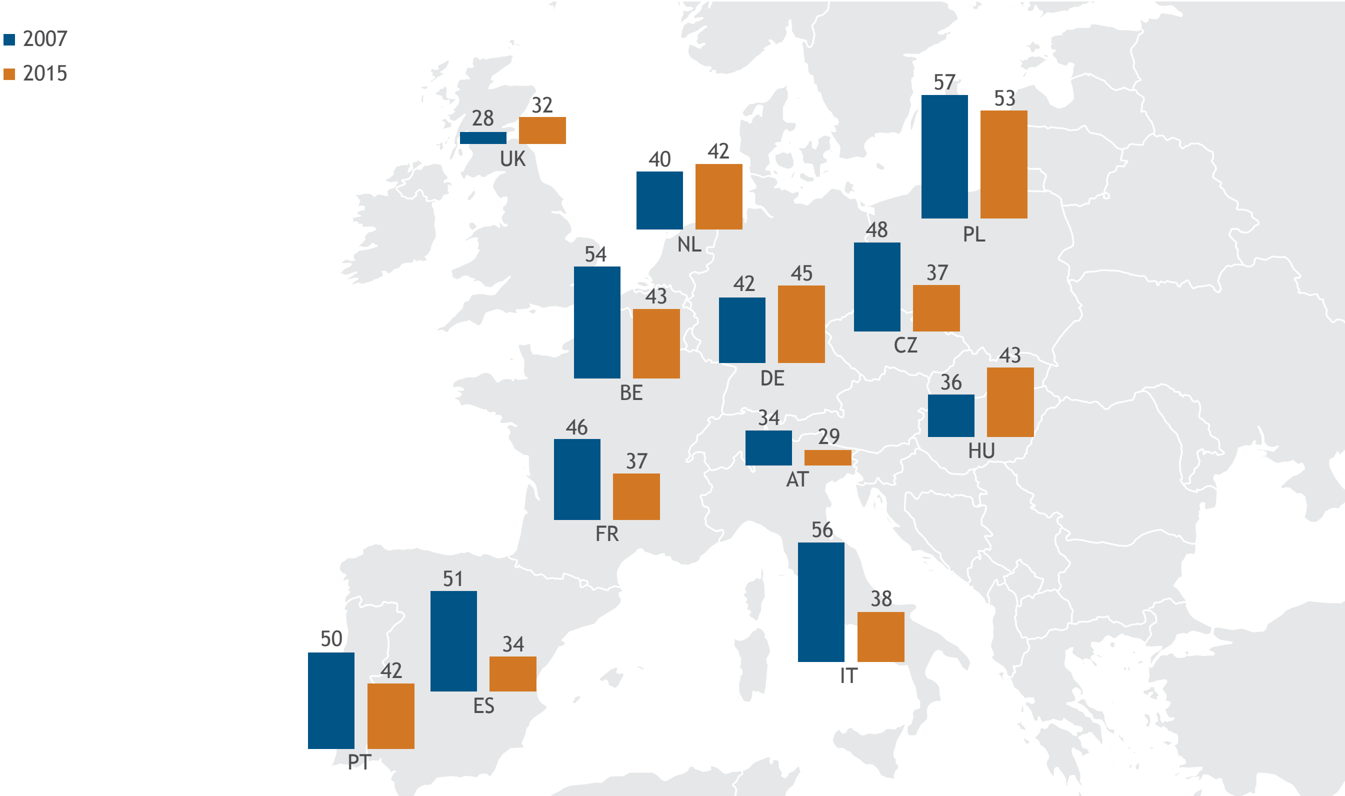
If the five years since 2010 have been years of potential jeopardy for the Eurozone, 2016 will extend the same sense of instability to the European Union itself. The drivers of Europe's euroscepticisms are multiple: the strains of large scale migration, a growing mood of nationalism, intolerance with the apparent transfers demanded by the securing of the Eurozone after 2011. Economic and social insecurity for which the EU is failing to provide a compelling political response is riling voters – and the EU itself is often seen as a part of the problem. The UK's crisis of European identity is perhaps the most profound of Europe's euroscepticisms – and the referendum in 2016 makes it the most material. But variants are now a feature in most European countries – sometimes focused on the aim of exit from the union, but more often built around a critique of the direction of travel towards greater integration.

In France, the Front National's rejection of EU integration and the reach of Brussels will shape the approach to – and the outcome of – the 2017 presidential election. In Germany, Angela Merkel faces her own Eurosceptic rumblings from the right wing of her CDU/CSU coalition and Alternativ fur Deutschland. Across Northern Europe, a cohort of cultural nationalists like the Danish People's Party are rejecting the implications of European integration for what they see as greater cultural cohesion. As the honeymoon of membership wears off after a decade, Europe's eastern states are also increasingly asserting their own autonomy inside the EU: most notably Poland, Hungary and the Czech Republic. Elite politics in Europe has often seen leadership as the ability to put European interests ahead of national ones. In 2016, a new cohort of aspirant leaders will be defining themselves against the EU. The impacts of these euroscepticisms will be material in 2016: constrained policy space to deal with single currency problems and migration issues. Most material of all, of course, is the UK, where voters could choose to leave the EU altogether – with dramatic and unpredictable consequences.

Roberto Robles

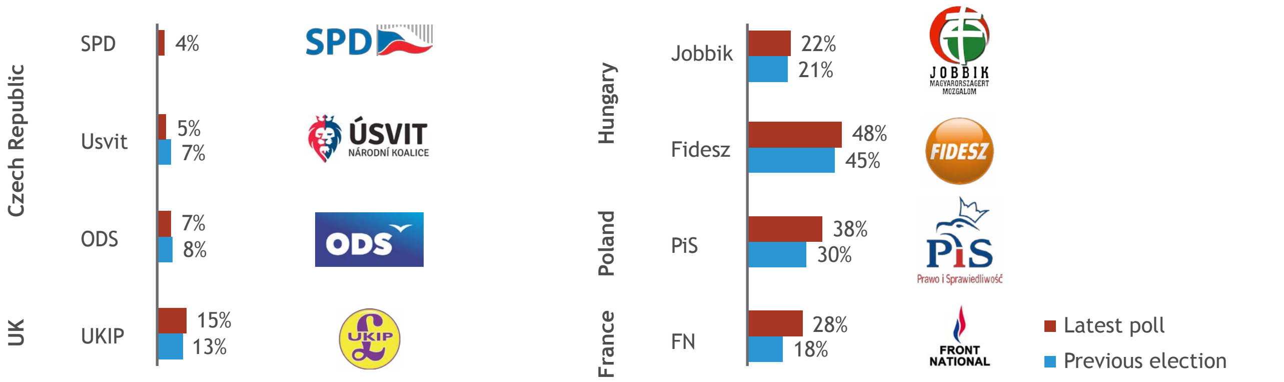
Views of the European Union

% saying they have a 'positive' view of the EU



Eurosceptic party polling

Previous election and current polling



Sources: Eurobarometer; public polls

Turkish President Erdogan will play a pivotal role in determining the flow of migrants into the EU in 2016 – and he will extract a price for his support.

External instability and internal strains

In 2016 Europe's external border will be more exposed and threatened by insecurity in neighbouring countries than it has been at any time in over a generation. Conflict in Ukraine, tensions with Russia, civil war in Syria, and state failure in Afghanistan and Libya have ringed Europe with instability. The last three have triggered a wave of human movement that has strained the EU's internal cohesion to the point of breaking.

The most immediate response has been to address these internal consequences, particularly as some of the pillars of European integration, such as Schengen, have been threatened. With internal freedom of movement, but no political consensus or practical system for distributing migrants and asylum seekers across countries, political tensions are high and internal frontier checks have reappeared in some parts of the EU. External frontier policing will be strengthened and the political debate on burden sharing will grind on.

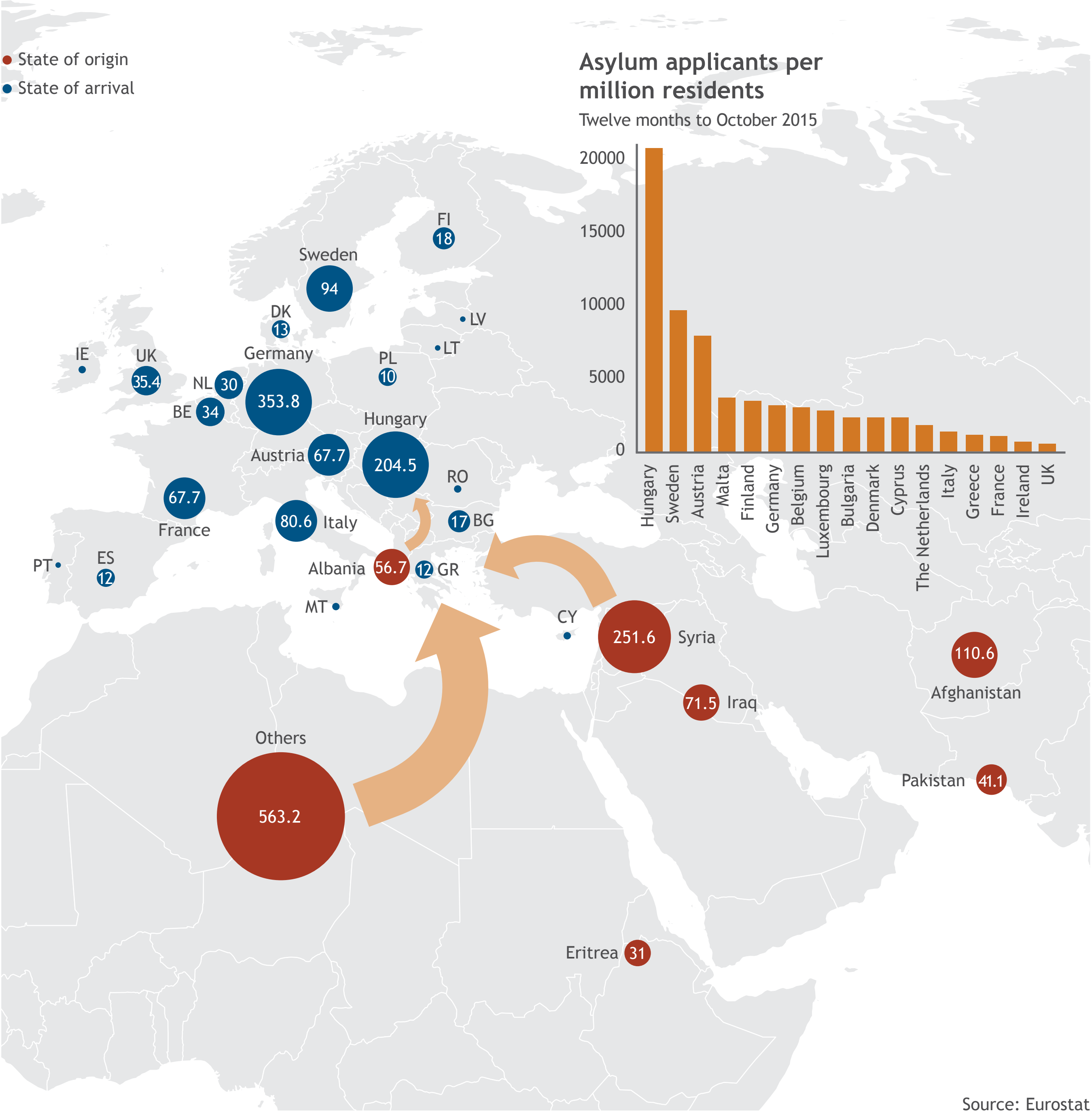
In 2016, however, attention will shift to external causes. Europe is a zone of prosperity ringed by intense poverty and insecurity and the EU's neighbourhood policy has failed. Some elements are being remade quickly and carelessly, particularly regarding Turkey, which has used the leverage afforded by its control over migration to win concessions on visas and EU accession negotiations. The UK has, on its own initiative, decided to allocate half of its aid budget – the largest in Europe – to fragile states, in order to slow the flow of migrants at source.

The test for policymakers across Europe in 2016 will be whether they can put aside dogmatic differences about the architecture of Europe's external policy and instead find pragmatic, cooperative responses that match the scale of the threat. Necessity may prove to be the mother of invention; but anyone expecting radical change quickly is likely to be disappointed.

Gregor Irwin

Asylum seekers to the EU, by origin and country of application, thousands

Twelve months to October 2015



Source: Eurostat

In 2015 E.ON CEO Johannes Teyssen made a bet on a "new energy world". In 2016 the EU's Energy Union agenda will go some way to determining his odds.

The new energy world?

2016 will be a defining year for European energy policy as it responds to the Paris agreement on climate change and powerful shifts in market sentiment and consumer and political expectation.

In 2015 E.ON Chief Executive Johannes Teyssen bet on what he called a 'new energy world' and has from 2016 spun out his 'old' businesses of conventional power generation from E.ON's renewables, grids, and retail businesses, effectively creating a carbon 'bad bank'. Other large European utilities looking at Germany's decentralised generation and low wholesale prices may conclude they are seeing the future as RWE has announced plans to followed suit. Market reaction to the splits will be watched closely, particularly in the context of investor concern about balance sheet exposure to carbon.

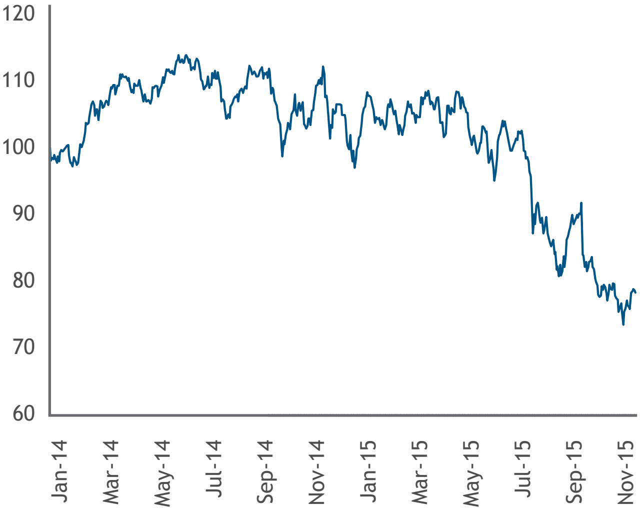
The extent and speed of structural change in the sector will also depend on policy. The European Commission and EU member states must now set out new policy frameworks to encourage the technological and commercial innovations that will be required if Europe is to meet its commitments under the Paris Agreement. The Commission will also begin rolling out a legislative programme for its Energy Union, which will cover everything from security of supply to energy efficiency and a governance system to oversee commitments and encourage implementation.

Expectations are being managed downwards, but what the Commission does will send important signals. Its proposals on power market design, in particular, are likely to heavily influence what Teyssen's new energy world will eventually look like – and how quickly we may get here.

Matthew Duhan

Index of 8 largest European energy utility valuations

100 = Jan 2014



EU policy commitments in the post-COP21 world

Decarbonisation	At least 40% reduction in emissions from 1990 levels by 2030.
Renewable energy	At least 27% share of renewable energy consumption by 2030: EU-wide with no specific member state targets.
Energy efficiency	At least 27% energy savings compared with BAU scenario [indicative].
Smart meters	At least 80% of electricity meters with smart meters by 2020 wherever cost effective.

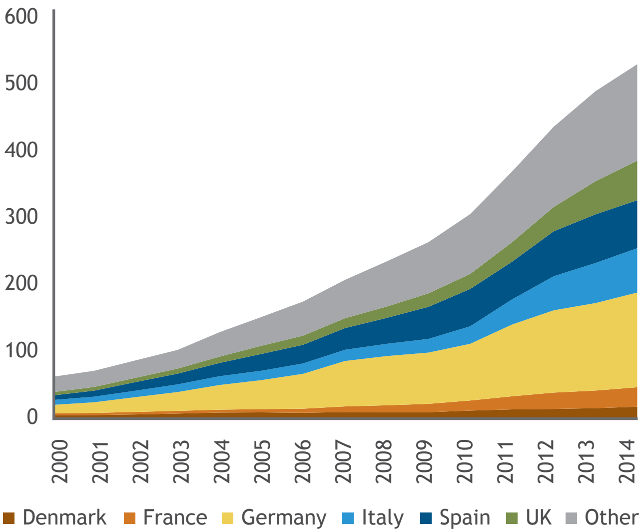
Uniper: energy's bad bank?

- Global energy trading
- Conventional power generation
- Exploration and production

E.ON: the 'new energy world'

- Renewables
- Energy networks
- Customer solutions
- Nuclear (required for regulatory reasons)

Renewable energy generation in Europe (excluding hydroelectric power) (Twh)



Sources: BP; E.ON; public market data

In 2016 policymakers like Anne Hidalgo will be looking for ways to make the 'gig economy' politically acceptable.

New ways of working

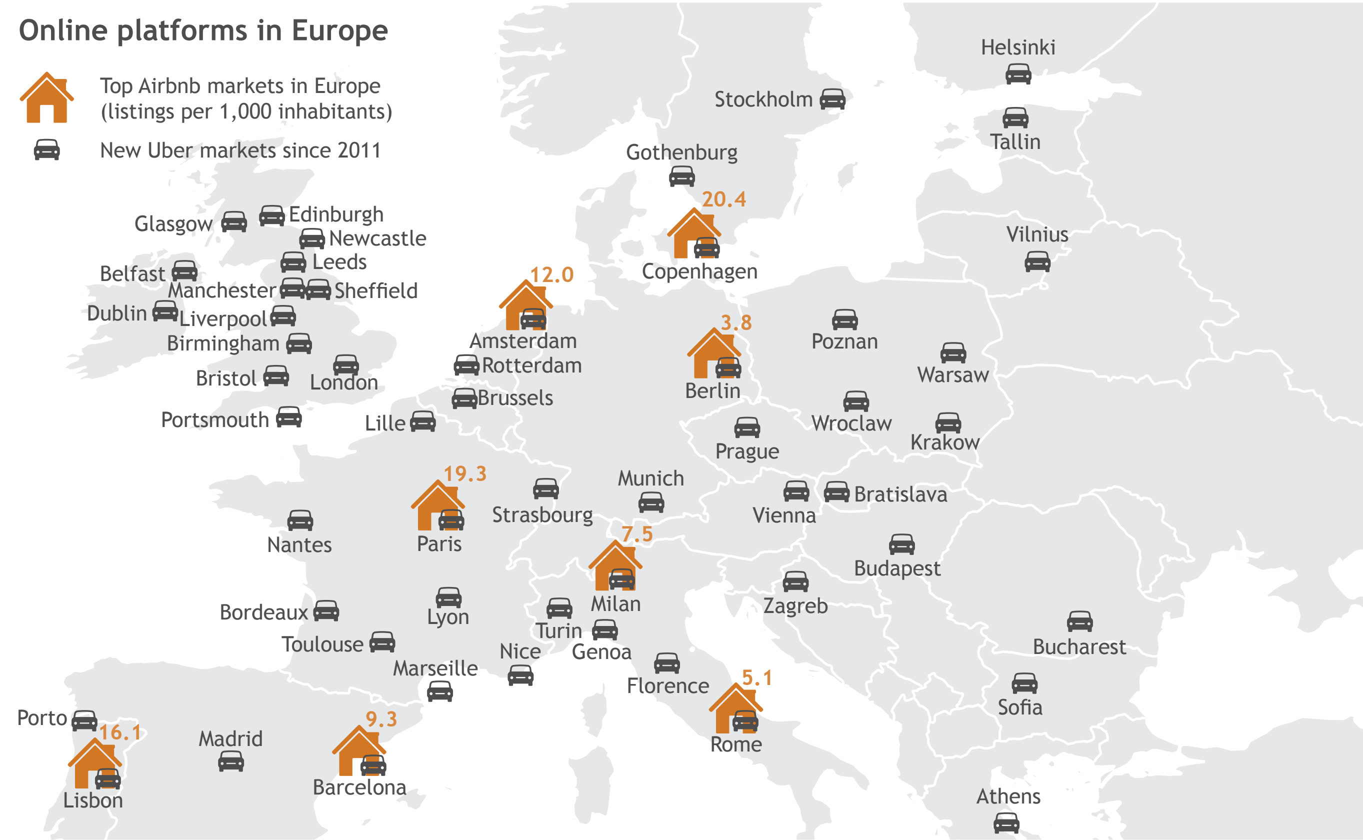
Few would dispute the fact that technology has changed the way Europeans work, but in 2016 the debate over technology's ability to reboot the labour market itself – by matching workers and work - will really hit its stride. The posterchildren for this potential have been ride-sharing app Uber and casual work platforms Handy and Taskrabbit. But home grown insurgents such as private-hire car company Cabify in Spain and the French long-distance and ride-sharing platform Bla Bla Car are doing the same sort of thing.

Policymakers - particularly on the centre left – appear torn between embracing the economic potential of these 'gig economy' innovations and worrying about their impact on incumbent players, employee protections and tax leakage. At one level the proposition is a politically welcome one: although the desire for self-employment has fallen over the crisis, but there is still a large gap in the EU between people who want to work for themselves. But policymakers also worry that self-employment can too often expand the grey economy and result in tax leakage.

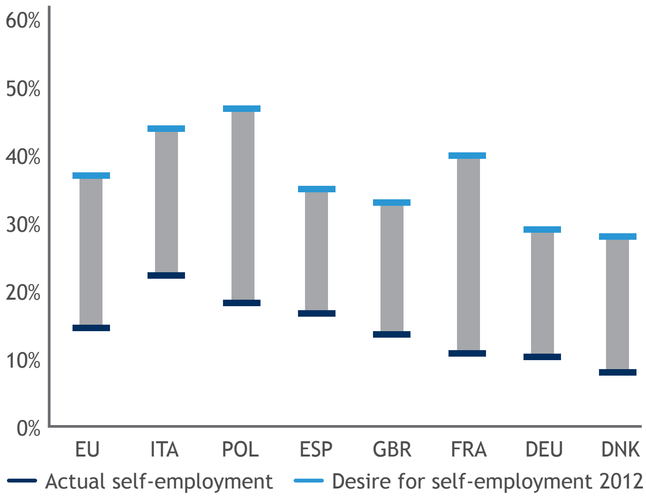
France has been just one battleground for these debates in 2015 and the Parti Socialiste (PS) has adopted a range of approaches: Paris Mayor Anne Hidalgo pragmatically struck a deal with Airbnb to ensure it automatically collects tourist tax for the city, but Prime Minister Manuel Valls introduced rules, later struck down by the courts, to limit the ability of Uber and other private hire vehicles to collect passengers. Economy Minister Emmanuel Macron, fresh from his success in liberalising the coach industry, will turn his attention in 2016 to deregulating the taxi and private hire markets. His choices will be watched closely.

Tom White

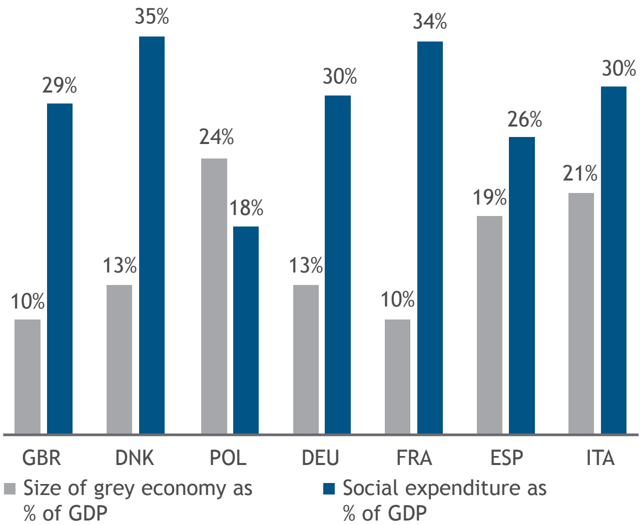
Online platforms in Europe



Europe's 'self-employment deficit'?



Grey economies and social expenditure



Sources: Airbnb; AT Kearney (2012); Eurobarometer (2009, 2012); Eurostat; Uber

In 2016 Margarethe Vestager and EU competition policy will continue to shape the future of European corporate consolidation.

Competition and consolidation

In 2016 European policymakers and corporates will continue to cast envious glances at the US and the platform that the US market provides for building scale – not least in the politically preeminent tech sector. Europe's own aspirant scale players have often come up against the problem of competition policy blocking national consolidation. Despite the creation of the European single market, markets remain fragmented enough for competition authorities to insist on seeing them as national in many areas.

There has long been pressure on EU competition policymakers to flex this check on consolidation in the name of building European scale – most recently in telecoms consolidation. The European competition authorities, under current Competition Commissioner Margarethe Vestager, don't seem to buy it, and a clear signal has been sent that the Commission's bias is strongly against allowing further national consolidation in markets already whittled down to four large players.

This resolve will be tested by the upcoming merger cases in 2016 between Three and O2 in the UK and Wind Italia and Three in Italy. Both look vulnerable to the Commission's new scepticism.
This suggests that the road to a new generation of European industrial champions may have to be cross-border. This is already happening in telcos. Another area where there is potential for this dynamic is banking, where consolidated national markets means scale may need to be a cross-border proposition. The shift to ECB supervision, active encouragement of cross-border liquidity, shifts to online banking and further encouragement of cross-border products and services could all support this.

Conan D'Arcy

Cross border consolidation in mobile in the EU, selected markets and players

	UK	Spain	France	Germany	Italy	Denmark	Netherlands
Deutsche Telekom	Expected exit 2016			39.0			3.7
Vodafone	18.4	14.2		30.9	25.2		5.2
Telefonica	24.5	17.6		42.1			
Hutchinson 3G	10.5				10.2	1.2	
Teliasonera		4.1				1.6	
Orange	Expected exit 2016	12.6	27.1				
			Bouygues 11.4		Wind 21.6	Telenor 2.0	KPN 7.5
			SFR 15.1		Telecom Italia 30.0	TDC 2.9	
			Free 11.3				

Deal likely to be notified to EC 2016

Possible deal in 2016

Deal collapsed June 2015 - Commission intended to block

Subscribers 2015 (mn)

National consolidations scrutinised by the European Commission 2015/16

Sources: Company statements

In 2016 ECB supervisor Danièle Nouy will declare most of Europe's largest banks sound - but they will still have difficult questions to answer.

Profitability under pressure

The G20 noted in November 2015 that the world's largest banks had made rapid progress in meeting new Basel III capital requirements. European stress tests in 2016 are likely to return a comparatively clear report card for European banks. This is an inflection point that will matter for many policymakers and politicians looking to put banking reform behind them. Stress tests in 2016 are likely to return a comparatively clear report card for European banks – an inflection point that will matter for many policymakers and politicians looking to put financial services reform behind them. For banks the challenge is shifting from defining the post-crisis rulebook to implementing and living with it. Banks and other financial services businesses, such as large insurers, impacted by the wave of reregulation since 2010, will shift from explaining regulatory impacts to policymakers, to explaining them to investors worried about profitability.

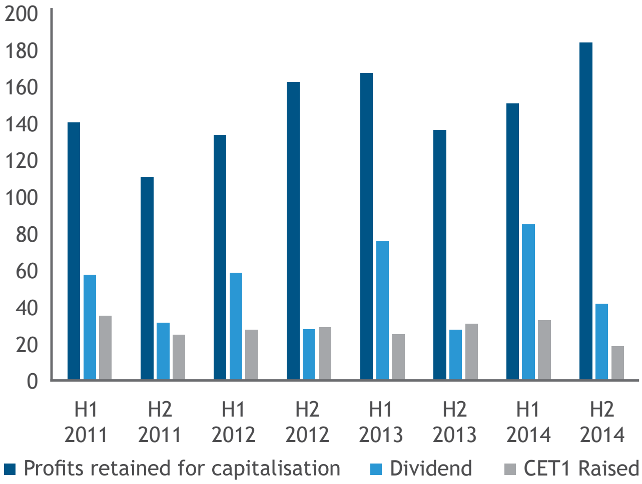
The new settlement means higher compliance costs, more intrusive supervisory standards and higher capital and liquidity requirements. For much of the last five years provisioning to meet new Basel III capital standards has sucked up profits that have not been returned to investors or recycled as new credit. Low rates and rising capital requirements have squeezed both profitability and returns on equity. Whether things look different in 2016 will in part depend on whether newly powerful regulators and supervisors like Danièle Nouy signal that they are satisfied.

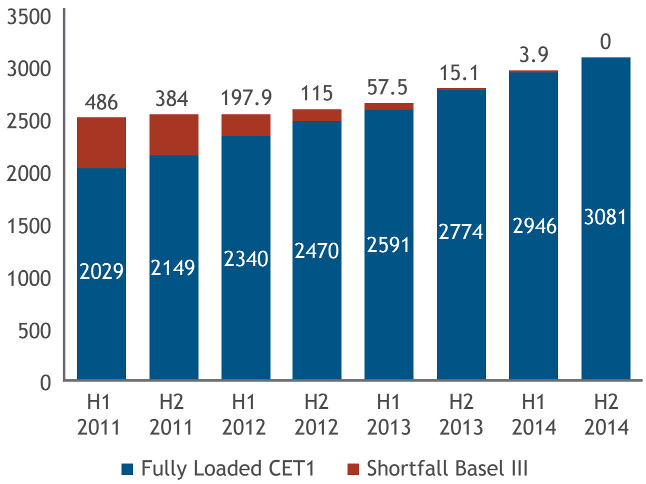
Even if they do so, the compliance costs of the new regime are significant, questions of culture continue to engage regulators and the implications of new bank resolution rules create new exposures for bank investors. A long tail of regulatory changes continues to work its way through the system: a possible Financial Transaction Tax and the details of bank structural reform proposals at the EU level. For asset managers buffeted by global volatility, the regulatory journey may only just be beginning. 2016 will probably be the year that policymakers declare Europe's banks fixed. Now they have to work out how to grow profitably and safely.

Stephen Adams

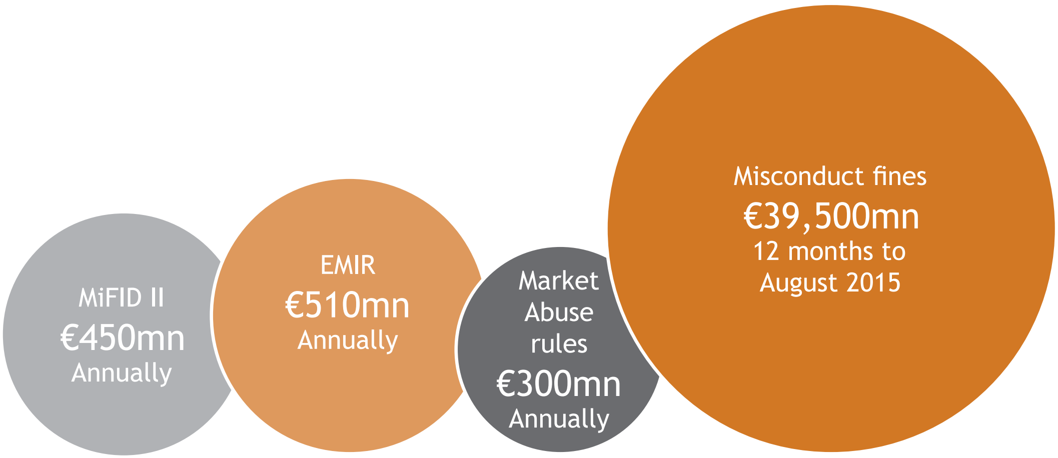
Provisioning against rising capital requirements has sucked up bank profits since 2011

Group 1 global banks (€bn)





Estimated annual costs of compliance with new financial services regulation...



...and the costs of noncompliance

Sources: BCBS Basel III implementation Review; European Commission; FT

In 2016 Matthias Müller will be worrying about emissions. He may also have a China problem.

Exports and growth

2015 saw a brightening of economic prospects in the Eurozone, but 2016 looks set to be a challenging year for European economies or companies betting on external export demand for growth. China's economic deceleration, as it continues its transition towards a more sustainable domestically-oriented economy, and the strengthening economic headwinds in other large emerging economies are both likely to depress global demand for European exports. Brazil is politically dysfunctional and deep in recession and Indian demand for EU goods remains modest. All this will be compounded by the knock-on effects from rate rises by the US Fed, which is likely to see the euro strengthen relative to more vulnerable emerging economy currencies.

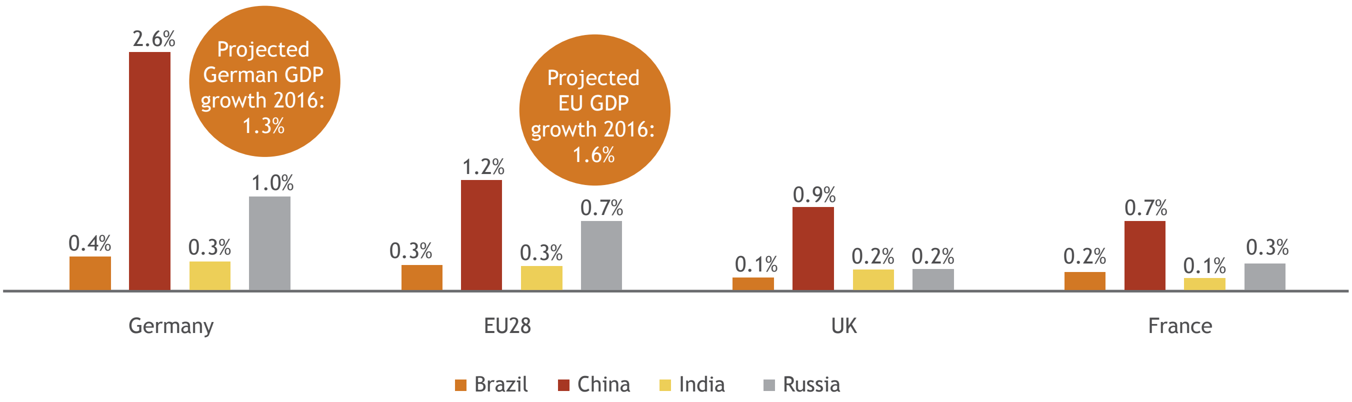
The German and European economies both have multiple exposures to China in 2016. China was the fourth-largest export market for Germany in 2014. A large share of these exports are heavy machinery and capital goods. Not only is Germany exposed to a cooling in Chinese demand, but it is particularly exposed to Chinese rebalancing. This effect on the German economy will ripple across the wider European economy, including through supply chains in central Europe and elsewhere.

The impact is uncertain and will be uneven across the Eurozone but will matter anywhere growing exports are being relied upon to boost growth. While low oil and commodity prices will cushion the macroeconomic impact, it could still put recovery at risk in some of the more troubled economies. It certainly means the European Central Bank will not follow the US Fed in tightening monetary policy any time soon.

Daniel Capparelli

2014 EU exports to the largest emerging economies

% GDP



Exposure to cooling (or rebalancing) China, selected EU companies

Company	Industry	Mkt Cap US$mn	Exposure %*
Volkswagen	Autos	97,381	c50
Swatch Group	Luxury goods	22,764	37
Standard Chartered	Banking	35,080	34
HSBC	Banking	172,220	33
BMW	Autos	63,695	35-40
ST Microelectronics	Semiconductors	7,054	30-35
Kone	Capital goods	18,887	30
Infineon	Semiconductors	12,414	20-25
Hermes Ltd	Luxury goods	39,513	20-25
ARM Holdings	Semiconductors	21,018	c25
Richemont	Luxury goods	42,832	24
Burberry Group	Luxury goods	10,640	23

* Share of total revenues from China

Sources: Eurostat; public statements; Citigroup

In 2015, privacy campaigner Max Schrems ended safe harbour. In 2016 we will have to work out what to put in its place.

Privacy and security

One of the EU's first major policy acts of 2016 will be the formal agreement of the deal struck between the EU institutions on data protection in December 2015. If this deal was made in the world of Edward Snowden, it will be implemented in the world of the Paris terrorist attacks, and of tension between privacy and the need for intelligence services to access and share data to ensure public safety.

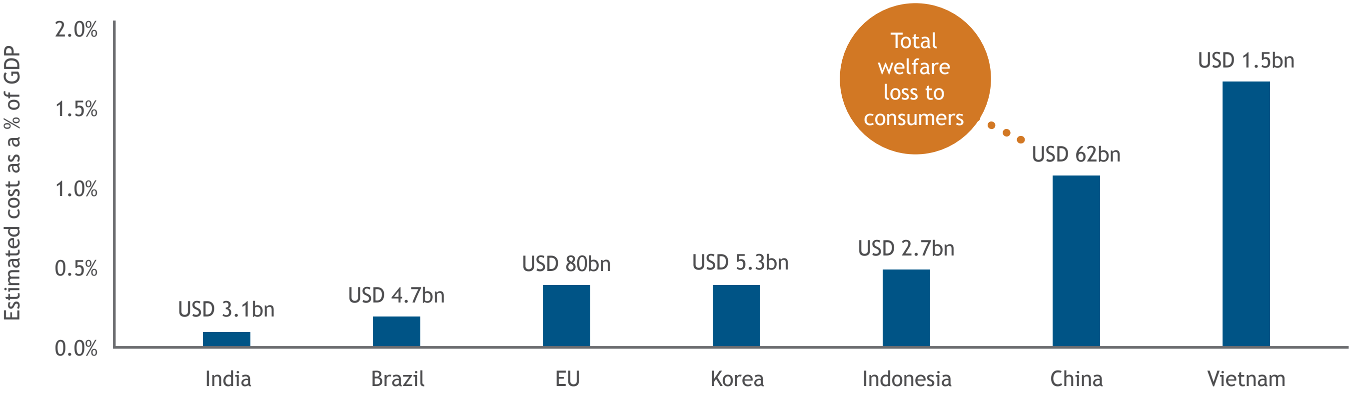
The EU's new data protection laws will ratchet up the rights to online privacy and sharply increase the sanctions for businesses that fail to respect them. Paris will create its own imperatives for security services that will in some respects pull in the other direction – and data handling businesses could easily find themselves caught in the middle. Businesses and policymakers are already dealing with the challenges created by the need for easy cross-border data transfer to allow competition in the digital sector, banking and other services, while ensuring the lines between privacy and security are clear and enforced.

The transatlantic relationship, in particular, faces three security and privacy tests in 2016. One is to ensure visa-free travel is not jeopardised by a failure to share counter-terrorism information. A second is to stablish new 'safe harbour' rules for data transfer after the current scheme was invalidated due to concerns about inadequate privacy protections in the US. A third is to agree principles for data transfer and protection in the Transatlantic Trade and Investment Partnership. There is plenty of work to be done within the EU as well - but what happens between the EU and the US is potentially of global significance as it sets a benchmark. Failure to find a solution to these problems could encourage (or excuse) other countries that want to pull down the data shutters and enforce costly data localisation, with the risk that the internet becomes fragmented along national lines.

Gregor Irwin

The cost of data localisation policies

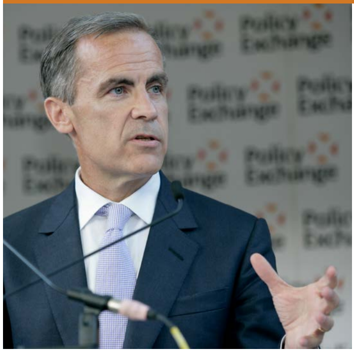
% GDP



Anticipated changes to EU data protection law 2016

Consent	New requirements that consent for data use must be 'unambiguously' given. Creates right to know when your data has been hacked.
Data Protection Officer	All large and medium-sized firms that hold data must appoint a data protection officer. SMEs exempted.
Liability for data breaches	Extends liability beyond the 'data controller' (often the customer) to also include 'data processers' (e.g. cloud computing companies). Companies can be fined up to 4% of annual sales for serious data breaches.
Non-EU headquartered companies	Companies which offer goods or services to EU citizens are treated in the same way as EU-headquartered companies.
Regulatory authority	One stop shop in the EU with regulatory disputes between member states officiated by the European Data Protection Board.
Request from non-EU governments	Provisions to prevent European companies from passing personal data of EU citizens to non-EU governments.
Right to be forgotten	Statutory right to request the deletion of personal data held by companies.

Source: ECIPE



In 2016 Mark Carney will continue to push markets to price carbon risk better.

Risk and responsibility

In 2016 the pressure on managers and boards to think in new ways about risk will continue to evolve. Changes to corporate governance codes across the EU since 2014 have created new obligations for both shareholders and boards to understand the risks companies are taking and to demonstrate a longer-term focus.

While few would argue with the aim of improving corporate governance after a long run of governance failings, the duties, expectations and potential sanctions for failures by EU directors are changing in ways that are important to understand and will require risk-averse non-executives to tread a delicate line between maintaining genuine independence and rigorously testing and overseeing internal control functions. The arrival of new EU non-financial disclosure rules will raise the stakes by opening up business operations to unprecedented levels of scrutiny. Moreover, political expectations of owners are rising alongside those of managers and directors, with the EU revisiting in 2016 the duties of institutional shareholders in a revised Shareholders' Rights Directive.

The scope of risks companies and investors are expected to understand and reflect is also changing, especially in the way they integrate environmental sustainability into their risk frameworks.
In 2016, the Financial Stability Board will launch work on voluntary disclosure standards for carbon risk that will see greater pressure on both companies to quantify their exposure to changing patterns of hydrocarbon use and institutional investors and lenders to define and disclose their investment policies on these issues. Investor pressure to divest from hydrocarbon assets remains a niche issue outside of a few areas such as coal, but the disclosure debate will pressure companies and investors to quantify carbon reliance not just according to their current 'footprint' but in terms of a viable pattern of use into an uncertain future.

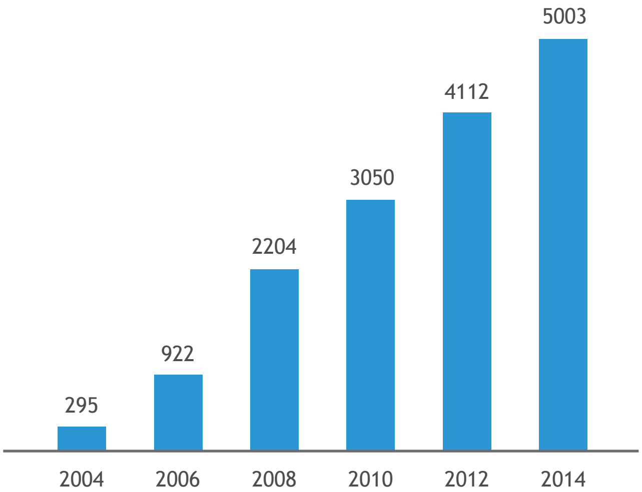
Leo Ringer

Evolving Governance expectations in 2016

Selected divestments from coal assets 2015

Fund	Divestment threshold*
Axa (May 2015)	50%
Allianz (November 2015)	30%
Church of England (July 2015)	10%
CALPERS (October 2015)**	50%
Norwegian Sovereign Wealth Fund (May 2015)	30%
Stanford University (June 2015)***	50%

Companies making carbon impact disclosures in reporting 2004-2014



* % investment company revenue from thermal coal. ** Divestment requirement is created by law, but made conditional on the fund's assessment of its fiduciary duty. *** Excludes coal mined for steel making.

Sources: CDP; public statements

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