European Economic and Social Committee

ECO/365
Long-term financing –
Follow-up

Brussels, 9 July 2014

OPINION

of the
European Economic and Social Committee
on the
Communication from the Commission to the European Parliament and the Council on Long-Term Financing of the European Economy
COM(2014) 168 final

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Rapporteur: **Mr Smyth**
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On 14 March 2014 the European Commission decided to consult the European Economic and Social Committee, under Article 304 of the Treaty on the Functioning of the European Union, on the

> *Communication from the Commission to the European Parliament and the Council on Long-Term Financing of the European Economy*
> COM(2014) 168 final.

The Section for Economic and Monetary Union and Economic and Social Cohesion, which was responsible for preparing the Committee's work on the subject, adopted its opinion on 17 June 2014.

At its 500th plenary session, held on 9 and 10 July 2014 (meeting of 9 July 2014), the European Economic and Social Committee adopted the following opinion by 139 votes to 2 with 3 abstentions.

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1. **Conclusions and recommendations**

1.1 The EESC broadly supports this Communication from the Commission which follows up on the Green Paper on long term financing of the European economy[1]. It represents a positive development of the policy debate about how best to meet the long term investment needs of Europe**.**

1.2 The EESC recognises that the Commission must operate within its areas of competence while at the same time encouraging appropriate institutional and policy changes at global and Member State levels. This is particularly important in the context of national and international regulatory regimes which influence the longer term time horizons of investment decisions. There is, for example, in many Member States a bias in fiscal systems in favour of debt financing of business which incentivises companies to utilise debt rather than equity as a source of funding. For a more diversified and stable long term financing of business, Member States need to be encouraged to promote greater use of equity investment. The Commission should continue to press for this.

1.3 Most of the proposals from the Commission in the Communication are sound and consistent with promoting a longer term investment horizon but they will take some time to implement. New instruments for long term investment (such as EU 2020 Project Bonds) are needed now and the EESC urges the Commission to move rapidly to implementation.

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1 COM(2013) 150 final/1 and COM(2013) 150 final/2.

1.4 In the context of promoting greater long term financing of the economy, the completion of a banking union is essential. Monetary policy should be accommodating to long term investment in terms of appropriate interest rates both for investors and savers. The EESC welcomes the commitment from the Commission to investigate the fragmented cross-border flows of savings and also to assess the feasibility of developing an EU-wide savings product.

1.5 The EESC believes that there is now a unique opportunity to articulate, develop and implement an EU framework for long term investment based upon the solid body of analytical work undertaken by, inter alia, the Commission, the International Institute of Finance and the Group of Thirty. The obstacles to sustainable long term finance are well known and need to be overcome. They centre on five main challenges:

- incentivising investors to take a longer term perspective in their investment decisions;
- creating new intermediaries and new instruments geared towards long term investment;
- developing debt and equity capital markets to broaden the range of financing instruments;
- ensuring that the flow of capital across borders is orderly and supportive of longer term investments; and
- developing better systemic analysis when framing future regulatory policy.

The EESC sees progress towards these objectives in this Communication and urges the Commission to maintain and accelerate this progress in its upcoming proposals on long term finance.

2. Follow-up to the Green Paper on long term financing

2.1 This Communication represents a considered response of the Commission to the successful consultation process engendered by the publication, in March 2013, of the Green Paper on long term financing of the European economy[2]. It sets out a number of proposals and actions designed to address the obstacles preventing the greater mobilisation of private and public sources of long-term financing. It is the view of the Commission that, while banks will continue to play an important role in the provision of longer term financing, alternative non-bank sources such as public funding, institutional investors (insurance companies and pension funds), traditional or alternative investment funds, sovereign wealth funds, etc. must be encouraged to provide such funding.

2.2 The actions proposed in this Communication focus on

i) mobilising private sources of long-term financing,
ii) making better use of public finance,
iii) developing capital markets,
iv) improving SMEs' access to financing,

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2 COM(2013) 150 final/1 and COM(2013) 150 final/2.

v) attracting private finance to infrastructure, and
vi) enhancing the overall environment for sustainable finance.

The Commission also published a proposal to revise the Institutions for Occupational Retirement Provisions (IORP) Directive[3] to support the further development of occupational pensions, an important type of long-term institutional investor in the EU, as well as a Communication on crowdfunding[4], a growing source of financing for SMEs.

3. Proposed actions

3.1 *Mobilising private sources of long-term financing*

3.1.1 There is an inevitable tension between, on the one hand, the need for enhanced capital and liquidity requirements on banks to increase their resilience and, on the other hand, the desire not to place excessive restrictions on banks that might discourage them from providing long-term finance to the real economy. Striking the right balance between these two important public policy objectives will not be an easy matter. The Commission will investigate the appropriateness of the capital requirements regulation in relation to long-term financing and review the extent to which the liquidity coverage ratio and the net stable funding ratio proposals may hamper long-term financing by the banking sector.

3.1.2 The Commission's view is that once the banking reforms and the banking union are completed, confidence in the financial sector will be restored and financial fragmentation will be greatly reduced. In particular the recent set of proposals on the structural reform of banks, by separating core real economy financing activities from more risky trading activities, should enable banks to resume their traditional role[5]. The EESC in its opinion on the restructuring package is supportive of the Commission’s proposals.

3.1.3 Perhaps the most interesting elements of the communication concern the rules of insurance companies and pension funds in long-term investment. A reformed Solvency II comes into force at the start of 2016 and it should enable insurance companies to invest in any kind of asset subject to the "prudent person principle". This has the potential to contribute to the development of sustainable markets in securitised instruments. In terms of pension funds, there are proposals to develop, in partnership with the European Insurance and Occupational Pensions Authority (EIOPA), a framework, leading to the creation of a single market for personal pensions in Europe, thereby potentially mobilising greater long-term savings.

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3 COM(2014) 167 final.

4 COM(2014) 172 final.

5 These proposals are considered in the EESC opinion INT/717 "Structural reform of EU banks".

3.1.4 In terms of mobilising more private funding for long term investment, the EESC recommends that the Commission also undertakes a feasibility study of utilising sovereign funds alongside more mainstream long term sources such as pension funds and the big insurers.

3.1.5 In its response to the Green Paper[6], the EESC recommended that the Commission investigate the introduction of an EU wide savings account to tap into long-term savings. The Commission will now undertake a study into the impediments to the creation of such a cross-border EU savings vehicle.

3.2 ***Making better use of public finance***

3.2.1 On the issue of achieving more effective use of public funding for long-term investment, the Commission commits to measures which should encourage greater cooperation between national and regional promotional banks, EIB/EIF and other multilateral development banks, such as the EBRD. The recent creation of the Strategic Banking Corporation of Ireland which is a joint venture between the Irish Government, the EIB and KfW[7] bank and which will have around EUR 800 million to lend to Irish SMEs is a good example of this approach. There is also a similar proposal in respect of better coordination and cooperation among national export credit agencies. These proposals are to be welcomed.

3.3 ***Developing capital markets***

3.3.1 Many of the Commission's proposals address the issue of underdeveloped capital markets in Europe. The Communication notes that although the corporate bond market has been growing in recent years, it remains (along with European equity markets) fragmented and unattractive to SMEs and mid-caps as a source of longer term finance. In response to this fragmentation, there is a commitment to a study into whether further measures, apart from MiFID 2[8], may be necessary to establish a robust and liquid secondary market in corporate bonds. There is also a commitment to investigate whether UCITS[9] could be extended to cover securities listed on SME growth markets.

3.3.2 Since the onset of the financial crisis, the term securitisation has been associated, by default, with sub-prime mortgages in the US and the collateralised debt obligations and credit default swaps derived from them. The catastrophic failure of the derivatives market was not caused by the securitisation of the assets themselves but by inadequate regulation, the lack of understanding and greed on the part of both buyers and sellers. The use of securitisation is now back firmly on the policy-making agenda. Risk retention requirements have been in

6 OJ C 327 of 12.11.2013, p. 11.

7 A German government-owned development bank

8 Markets in Financial Instruments Directive

9 Undertakings for Collective Investment in Transferable Securities, Directive 2001/107/EC and 2001/108/EC.

place since 2011 across the EU and disclosure obligations to allow investors to better understand the financial instruments in which they invest have been reinforced. In the opinion of the Commission there is now scope to establish sustainable securitisation markets with appropriate prudential differentiation of the different asset-backed securities to be traded. While the EESC supports the gradual use of securitisation in principle it urges caution so as to ensure that its use is implemented in a well regulated manner.

3.3.3 The Commission pledges to cooperate with the Basel Committee and the International Organisation of Securities Commissions (IOSCO) to develop and implement global standards on risk retention, transparency, consistency in securitised markets. There is also a commitment to reviewing the treatment of covered bonds in the Capital Requirements Regulation (CRR) by the end of this year as appropriate to the establishment of an integrated covered bond market; in turn this review should accelerate a study on an EU framework for covered bonds.

3.3.4 The issue of private placements is reviewed in the Communication and as private placements are seen as a realistic alternative to bank lending and to public corporate bond issuance there is a commitment to an analysis of good practice in private placement markets in Europe and elsewhere and to develop proposals for the more widespread use of such placements in the EU.

3.4 ***Improving SMEs' access to financing***

3.4.1 The Communication also touches upon the thorny issue of improving SME access to longer term financing. This topic formed part of the Action Plan on SME financing published in 2011 and some limited progress has been made since then. The lack of adequate, comparable, reliable and readily available credit information on SMEs is identified as the chief impediment to greater access to capital markets. One of the causes of these inadequacies is the fragmented nature of national sources of such information.

3.4.2 In a recent influential study[10] the International Institute of Finance (IIF) cited these informational asymmetries as a major impediment to SME funding in both the short and long-term. The IIF proposes a series of measures to lessen these impediments. They include greater use of digital repositories with standard submissions for business registers, statistics offices, bank credit assessments and other lenders. These national repositories of credit risk data should be consolidated with the European Data Warehouse, eventually leading to a European central credit registry. The IIF calls for the setting of Europe wide standards for information collection and reporting so as to enable cross company and cross national analyses. Better, more up-to-date information on SME financial performance should enable better risk assessment by lenders and more appropriate pricing of risk. The IIF proposals go much

10 Restoring Financing and Growth to Europe's SMEs (2013).

further than the Commission's and the EESC urges the Commission to tackle these national informational/confidentiality issues as a matter of urgency.

3.4.3 The EESC sees merit in giving a role to Regional Development Agencies (RDA) in the assessment of SME riskiness. Most EU regions have such RDAs, some of which already providing equity and debt finance to client SMEs. These RDAs often have better knowledge of SMEs and their owner-operators and management than banks and the EESC recommends that the Commission investigates their potential role as local risk assessors.

3.4.4 There is also a commitment by the Commission to resume the dialogue between banks and SMEs with a view to improving the latter's financial literacy, particularly with regards to the feedback provided by banks on loan applications. The IIF study goes further and recommends the education of SMEs on available alternative funding options and the benefits of participating in alternative funding programs. The EESC endorses this view.

3.5 ***Attracting private finance to infrastructure***

3.5.1 In terms of infrastructure investment, the Commission identifies the lack of consistency of available data on the performance of infrastructure loans across Europe as an obstacle to greater private sector participation in infrastructure investment. Commercial sensitivity and confidentiality on the part of banks and equity investors often prohibited the wider circulation of relevant information. The Commission commits to an evaluation of the potential for a single portal to make available, on a voluntary basis, existing information on infrastructure investment plans and projects by municipal, regional and national authorities. A similar portal approach to making available comprehensive and standardise credit statistics on infrastructure debt is also proposed. The EESC supports these actions.

3.6 ***Enhancing the overall environment for sustainable finance***

3.6.1 Aside from the issue specific actions discussed above, the Commission also examines the wider framework for sustainable finance in terms of corporate governance, accounting standards, taxation and the legal environment. It will consider a proposal for the revision of the shareholder rights directive to bring the long-term interests of institutional investors, asset managers and companies into a better alignment. The EESC is supportive of this revision of the shareholder rights directive to encourage longer term shareholder engagement.

3.6.2 There will also be an assessment of employee share ownership (ESO) and employee financial participation (EFP) schemes across the EU, with a view to identifying impediments to the cross-border implementation of such schemes and formulating actions to address them. There is also a commitment to consider whether the use of fair value in the revised IFRS 9 is appropriate in respect of long-term investing business models. In addition, the Commission will launch a consultation later this year to examine the case for a simplified accounting standard for the financial statements of listed SMEs and the utility of a self-standing accounting standard for non-listed SMEs.

3.6.3 There is recognition in the Communication of fiscal bias towards debt financing of business across most Member States of the European Union. This has the effect of incentivising companies to take on more debt rather than use equity. The Commission has no competence in this area and the Communication merely commits it, through the country specific recommendations of the European semester process, to promote greater equity investment. Finally, the Commission will undertake reviews of the recent recommendation on the early restructuring of viable enterprises and the principle of "second chance" in respect of bankrupt entrepreneurs, as well as the law applicable to third party aspects of the assignment of claims. There is little to find fault with in these proposals.

Brussels, 9 July 2014

The President
of the
European Economic and Social Committee

Henri Malosse

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