EAPB response to consultation on Long–Term financing for the European Economy

The EAPB welcomes the opportunity to respond to the consultation on Long–Term financing for the European Economy. The consultation launches a wider debate on how to foster the supply of long–term financing and how to improve and diversify the system of financial intermediation.

In the Green Paper the European Commission rightly highlights the important role of public development banks and public long–term investors in countering negative economic cycles and in the stimulation of private financing as they are committed to the public interest. In our view the existing regional and national structures of promotional funding in the different Member States should be included in the general efforts to promote long–term–financing. While it is important to maintain a level–playing field between different commercial finance providers, the EAPB considers that the specific situations of public development banks, funding agencies and public long–term investors must be considered in European financial regulations.

Please find below or comments on certain key aspects of the Green paper.
Definition of long-term financing
It is of course difficult to have an overall definition of long-term financing, but the working definition in the Green paper could have benefited from further specification to have a more targeted debate. The definition may differ depending if it refers to SME funding or to project financing. In the field of company funding a financing over five years may be considered long while for projects ten years would rather be considered long-term. It should, however, be noted that also short-term revolving credits may have long-term financing effects.

Role of banks in financing the European Economy
The role of banks in long-term financing of the real economy is strongly dependent on the company culture of companies. While in some countries companies are mainly financed by the capital markets, in most EU Member States SMEs trust banking loans in the field of long-term financing. These have stood up to the tests of time and the crisis. In this respect, EU guarantee instruments can contribute to risk-sharing in the granting of credits as banks have to foresee less own capital. This is especially important for start-ups and innovative companies. Well established economic structures should therefore not be changed by regulations.

National and multilateral development banks
The general objectives of public banks and public long-term investors are defined by public law. This includes financing SMEs, infrastructure, environmental or social projects as well as municipalities. While EAPB members perform their activities in line with sound business management there main aim cannot be to maximize profit. The specific business models designed to meet public-interest objectives may differ from Member State to Member State, but many public financing tools have in common that they aim at correcting the private sector’s short-sightedness which may to some extent be encouraged by current regulations.

Development banks, funding agencies and public long-term investors have different instruments at their disposal, including through indirect financing mechanisms via commercial banks. These public financing models allow incentivizing private funding by sharing the associated risks (e.g. by forming consortia in the financing of projects or by providing guarantees). Development banks can further provide credits with preferential interest rates as well as mezzanine financing. Development banks as well as local funding agencies can also often mobilize funds from capital markets and use them to satisfy long-term funding needs for example for local infrastructure or social projects. Risks can also be shared with the support of European Institutions, the European Investment Bank of the EIF.

In general, the EAPB welcomes the greater use of financial instruments under the EU budget. In this context the European Commission should make sure that that the duration of its programmes (e.g. COSME or HORIZON 2020) is in line with the objective of long-term financing. It would be problematic if the Commission continues to limit the duration to seven years. EU programme guarantees should be granted as long as possible. Further
harmonization of the objectives activities of the programmes of different DGs (DG Entreprise, DG REGIO) would also be welcome.

While at European level funds can be mobilised on a larger scale, for example in the area of risk capital, national and regional institutions have a profound knowledge of the respective local economic structures and actors, which is employed to the benefit of SMEs. Therefore it is of high importance for an effective public funding system in the EU that European, national and regional public funding institutions work together in line with the subsidiarity principle. National and regional public development institutions should not be discouraged to play their part by overly burdensome rules, for example in the field of State aid law for example with overly restrictive branch–related or region–specific conditions.

**Institutional investors**

From a wider perspective, institutional investors have a clear role to play. However, these financiers do not have the years of expertise and know–how in risk management that the banks have. This shortcoming demonstrates the need for long–term collaborative models between institutional investors and (national) banks. Otherwise there is the risk that institutional investors will focus only on clearly identifiable low risks (i.e. flight to quality) meaning that the banks are restricted to funding higher risks (i.e. more capital requirements) – a situation that will not expedite their recovery and will not work in favour of the desire for real economic growth.

**Combined effects of regulatory reform on financial institutions**

While it is difficult to estimate the overall impact of new regulation introduced since the financial crisis, it appears that the introduction of many measures at the same time seems to lack an overall concept. It would have been preferable to introduce measures successively with careful consideration for long–term financing.

In addition to the restraints on development banking activities provided by EU State aid rules and public law (e.g. public procurement rules), most of the institutions are also subject to general banking regulations (e.g. on capital requirements, crisis management, financial transaction tax, anti–money laundering compliance rules etc.). Therefore the EAPB would welcome an overall impact analysis of the introduced regulations.

The lack of consideration for public banking specificities in European financial regulation is often a serious obstacle for meeting EAPB members’ objectives including in the field of long–term financing. Allowing such institutions to fully play their role is fully in line with the Commission objective to allow regional and national governments to “play a key role in the provision of public goods and public infrastructure (and) greater spending efficiency through systematic cost–benefits analysis and careful project screening”.

**Capital markets /covered bonds**

With regard to covered bonds, any kind of harmonisation – whether it be with respect to reporting, transparency or quality of underlying assets – should not lead to a deterioration of
high-qualitative national legislation. For example, the legal framework for the German Pfandbriefe is a rather strict regulation that makes the product safe, particularly the requirement to underlie the bond with prime collateral ("Deckungsstock"). In addition, covered bond transactions should happen on a bank’s balance sheet. Therefore, any regulation should foresee high-quality minimum standards.

**Tax incentives**
A wide range of models exist in Europe. The success of special tax incentives e.g. on savings accounts depend heavily on different social and economic interlinked conditions in the national markets. While they have been successful in some Member States (e.g. France), they would not necessarily work in others. It seems difficult to transpose certain measures to other Member States or to “upload” them at EU level.

**Accounting principles**
For many public developments banks and long-term investors IFRS have important shortcomings and do not sufficiently take into consideration the business model of an entity. EAPB considers that the valuation of financial instruments at fair value may lead to short-term valuation advantages and for example may be reported as profits. This could affect a long-term financial orientation of entities. In this context the right categorization of financial instruments in terms of accounting is crucial. Mark-to-market valuation should be one of the options for accounting, but not the “default” one as long as long-term investment is concerned. In particular IFRS 9 should be adapted to take into account the specific characteristics of long-term investments. Therefore the EAPB fully supports a reflection process on alternatives (e.g. a specific category) in order to make IFRS more suitable to long term financing.

**Reporting of non-financial information**
EAPB members are fully committed to sustainable development. The (non-financial) environmental and social factors are closely linked with economic factors. Non-financial information provide information on the activities of an entity and thus give a more complete picture of it for example concerning the strategy of the company, how efficiently resources being are used or to what extent social standards and human rights are respected. It also allows to get a picture on how focused a company is on short-term profit. Consequently such information can clarify the long-term business activities of a company. Such information has a considerable impact on the reputation of an institution which can also have an impact on its economic success. However EAPB members do not believe that further binding requirements are necessary. This is because reporting mechanisms as well as sustainability reporting rating agencies are in place and well-functioning. These give sufficient regular benchmarks on sustainability.
Ease of SMEs to access bank and non-bank financing

Preferential loans and guarantees provided by public development banks, generally distributed by commercial banks provide a good alternative to credits purely provided by commercial banks.

Further restrictions on LTF: State aid rules
On 8 May 2012 the Commission has published a Communication on the modernisation of State aid control, including efforts to closely define concepts such as market failure or incentive effects. The main elements of the reform shall be in place by the end of 2013. The Commission has launched several consultations on State aid, including the rules for regional aid, environmental protection in the General Block Exemption regulation, the de–minimis Regulation, the guidelines on Risk Capital and the State aid procedures. Horizontal guidelines on key State aid concepts are expected for the end of 2013.

Unfortunately the European Commission seems to be taking a restrictive approach in its recent decisions and rules by imposing new burdens on development banks and funding agencies. The Commission increasingly lays the focus on the proof of market failures, their sectorial scope, their expected timescale and total funding gap necessary to correct them, thus increasing the complexity of rules on the basis of which public developments banks may become active. The national and regional public development banks are charged with heavy documentation and reporting requirements. This risks jeopardising their business model and undermining the fulfilling of their mandate to promote the European economy and its financing in the long-term.