

Stockholm

December 4, 2017



Public consultation on Building a Capital Markets Union (May 12 2015)

Firstly, it is important to stress that NFU wants fair regulation in the financial sectors in order for companies to operate and perform in such a way as to support long-term oriented and sustainable growth for the benefit of society and the wider economy. NFU finds it important that after years of intensifying the regulation of traditional finance, enhancing the capital market union requires that what is today known as the shadow banking system, is appropriately regulated. In this way, transparency is increased, the investor knows what he/she is investing in and the risks of spill-over effects to the financial system can be monitored. We here refer for example to the importance of transparent securitisation. The capital markets union should also not hinder banks and other regulated financial institutions from continuing to be the key actor for providing funding and investments for the real economy. Rather, we suggest that ways are investigated to increase the synergy between banking and the capital market.

NFU is worried that the Commission's focus to increase funding to the economy from new and alternative sources will create new systemic risks in the financial system. The Commission should work to appropriately regulate all relevant financial institutions and to ensure a level playing field.

Questions:

5) What further measures could help to increase access to funding and channelling of funds to those who need them?

Nordic Financial Unions (NFU) would like to point to two domains of possible synergy between banking and capital market financing.

First of all, it is NFU's view, that the proper and continued education of staff, which have traditionally been the foremost advisors to retail investors and capital seekers is an important goal. This education needs to a) keep employees up to date on which forms and sources of alternative financing there are and b) be as impartial as possible, highlighting both benefits and drawbacks with each alternative, with no strings attached for either party involved. It should be clear that educational measures are done on working time.

Secondly, NFU believes that a fruitful synergy between banking and capital market finance could be created by including information on the origination of credits as a prerequisite of transparent securitisations. The prelude to the financial crisis was characterized by a lowering of standards in the credit origination process. Whether it refers to SME loans, or to real estate loans, we believe that a sound credit origination is beneficial to reducing the credit risk. This is related to our focus as employee representatives, as an experienced and well-trained banking staff underpins a sound credit origination process.

A more general aspect that in the eyes of NFU needs to be addressed, is the possible link between this proposal and the ongoing TTIP negotiations. Will the implementation of the Green Paper objectives, i.e. more financing across markets, not open a competitive edge to US-based financial corporations that are more experienced in market-based financing than European

ones? NFU would argue from a global financial stability perspective, that a diversity of models of finance makes the entire system more stable (competition among systems).

In extension, even though the Commission's own justifications for the necessity of this proposal mentions 5 times more capital being available in the US market, a pertinent question would be, whether there is an actual need for more capital and funding or just a need to relax regulatory barriers in the banking sector?

If the objective is to open up for more sources of funding, then already without a Capital Markets Union, the growth of financial assets and capital markets is already startling without any action taken by regulators. To quote from the Green Paper itself (page 7): "*Capital markets have expanded in the EU over recent decades. Total EU stock market capitalisation, for example, amounted to €8.4 trillion (around 65% of GDP) by end 2013, compared to €1.3 trillion in 1992 (22% of GDP). The total value of outstanding debt securities exceeded €22.3 trillion (171% of GDP) in 2013, compared to €4.7 trillion (74% of GDP) in 1992.*"

This growth has outpaced by far the GDP growth in the EU. Providing even more incentives and possibilities to generate and trade financial assets may go in the wrong direction and increasingly put more individual investors in risk of losing their assets. By at least allowing for banks to assume most of the risk, by relaxing regulatory barriers to the extent needed, some degree of safety is kept in the system and the institutions experienced in this field, i.e. banks, allowed to serve one of their primary purposes.

Further, through well-educated staff, financial institutions will in addition to quantitative risk measures, be able to do qualitative assessments. Well-educated staff is not only important for risk assessing and productivity gains, but for consumer protection too. Financial companies must therefore provide employees with the adequate skills, time and resources to be able to inform the clients and give good advice on financial products.

There is a risk that a Capital Markets Union will increase international competition to the disadvantage of financial institutions that have a strong local focus. Credits to SMEs are most often supplied by traditional financial services, typically provided by banks that have local knowledge and presence thanks to branch offices.¹ Further, as the origin of the financial crisis showed, too risky securitized products were issued with almost no documentation of the clients. But in the instances when bank employees happened to know the clients, lending practices were better and the securitized products at least slightly more solid as a consequence. Against this background, it is important that a Capital Markets Union also works in favor of financial institutions with local knowledge and presence, that are staff intensive and not least ensures proper and continued education of the staff.

8) Is there value in developing a common EU level accounting standard for SMEs listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

The "development of a common minimum set of comparable information for credit reporting and assessment" and credit scoring (Question 2) in conjunction with a new accounting standard for SME's (Question 8) is an additional burden for such SMEs, who doesn't need the capital market, but have a good relationship with their bank. There is a danger, that external credit rating will

¹ European Commission. 2013. Green Paper: Long-term financing of the European economy. Page 2-6
New Economics Foundation (NEF). 2015. Reforming RBS: Local banking for the public good. Page 17-19

play a bigger role in the credit decisions of banks, rather than the internal knowledge about the client.

9) Are there barriers to the development of appropriately regulated crowdfunding or peer-to-peer platforms including on a cross border basis? If so, how should they be addressed?

Following the likely increase of the amount of credits distributed through crowdfunding, the Commission must look at how to properly regulate and supervise such practices. Shadow banking activities are not only an issue for a safe and robust financial system, but risk making necessary regulations become a competitive disadvantage. Areas that are outside of the traditional financial sector should conform to the same rules as the rest.

However, in relation to the practice of crowdfunding, the scale on which it is employed is important. When employed on a small scale, the implications for society as a whole will be very small and most involved investors be highly involved in the product they are financing. However, when used on a large scale, especially when conducted over the internet and with varying degrees of accountability, the risks increase.

While NFU is not opposed to the concept of direct funding, we simply recommend adopting a cautious approach, where the scale of direct funding amounts are capped or projects are kept to industries that require low amounts of funding. When involving large numbers of investors, making sure they are all properly aware of the risks involved should be a priority. For projects requiring more funding, the bank's intermediation is a safeguard against losses and banks should therefore be relied upon. Otherwise sufficient regulation and supervision must be ensured, primarily in the interest of retail investors that must be entitled to a similar protection as when investing through the regulated part of the financial sector. In this respect, NFU also points at the advice of the ESMA stakeholder group on crowdfunding, p 75. (ESMA/2014/SMSG/010, 10 April 2014): "...in the MIFID context investment products should be appropriate to the investor's profile. To the extent that more leniency would be offered in crowdfunding investments, this should be balanced by some type of limits on maximum investor amount, either in absolute or relative terms."

13) Would the introduction of a standardized product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

In a number of member states, pension schemes have existed for a long time, are regulated and function well. EU regulation could help strengthen weak pension systems but should ensure not to disturb tailor-made best practices. Many of the EU citizens taking advantage of the possibilities to work and live in different countries granted by the Single Market, will find themselves facing an increased administrative burden when retiring. With different pension rules in different EU countries, and complications in pooling payouts to the current country of residence, the market is ripe for an overhaul, which enables EU citizens to pay pension provisions in different countries during their work life and face only one set of rules when retiring. In this sense, the market is open for more initiatives like RESAVER (ec.europa.eu/euraxess/index.cfm/rights/resaver) and TTYPE project (pensionstogether.eu), currently being prepared by the Commission.

On another note, many pension funds have a form of democratic control and often have social partners on their boards. Their activities are fundamentally different to that of a commercial undertaking, and should hence not be treated in the same way. It is UEFs opinion that

strengthening the single market in pension provisions should not go to the detriment of existing national provisions of participations by the social partners.

Finally, it is the opinion of NFU that while opening up for the possibility that pension funds can become investors, due diligence should be paid in order to insure that pensioners' money is properly handled.

16) Are there impediments to increase both bank and non-bank direct lending safely to companies that need finance?

As long as an even playing field in terms of regulation is ensured, for both types of providers of financing, NFU sees no impediments. A standardized regulation for certain types of high quality securitisations and standards on transparent securitisations might help in this respect. In this respect, we also repeat our earlier point that information on the origination of the underlying credits is a prerequisite for transparent securitisations.

18) How can the ESAs further contribute to ensuring consumer and investor protection?

In the Banking Union, consumer protection is left to national authorities. At the same time, in the regulations establishing the ESAs, consumer protection is one of the tasks of the ESAs. In this respect, a number of guidelines and warnings have already been issued by the ESAs. The ESAs have been developing this aspect of their work substantially and work together on common issues in a joint committee (i.e. on cross-selling practices). It is however the opinion of NFU that the ESAs should be granted increased supervisory and regulatory powers on the functioning of the capital markets to further protect the investors and consumers, as well as support market stability. This is in part due to their member's expertise in the field and the composition of their stakeholder groups. Powerful tools, entirely possible within the current legislative framework, could be peer review of national supervisors and supervisory convergence. This implies that the ESA's should get the appropriate means, including budgetary means, to work on this.

Finally, it must be added, that it is a democratic problem that the EU, through the ESAs, gives guidelines on issues that it does not have mandate to discuss. For example, remuneration policy (according to the TFEU article 153.5).

19) What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

Much retail investment is done based on the advice of bank employees and financial advisors. It is therefore important that the staff providing this advice is properly equipped to provide the best advice, in terms of education and working conditions. These are issues also addressed in the MIFID directive, but need to be properly protected in this case as well.

Furthermore, the question of how promoting retail investment should lead to a more stable growth needs to be re-examined. By taking capital from savings accounts and injecting it into the capital markets on a retail basis (as this is for example the case with French life insurance), a stable source of funding for banks disappear, which would leave banks forced to look elsewhere for this funding. Not only will this potentially lead to a more fragile banking structure and higher costs of funding for banks, but it could also lead to more impulsive behavior on behalf of investors and potentially lower average risk-adjusted returns on investment for the individual.

21) Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?

Since the financial crisis in 2008, more than 40 new Directives and Regulations have been issued by the European Commission and policies developed by the SSM and ECB. In the view of NFU, this amount of new legislation needs time to be properly integrated into the financial sector and a period of stabilization must be allowed to properly assess the impact on the industry, consumers and employees. Over-activity in the regulatory arena may lead to unwanted effects, putting additional pressure on an industry that needs to find its way back to a stable path. At the moment, signs are already appearing of a potential overregulation or miss-regulation of the market with smaller banks in several countries having to close down due to increased reporting requirements. Before their cases have been properly examined and short/medium term effects of the current legislation can be determined, further legislation would be detrimental to the sector it is attempting to improve.

It is also crucial the regulated financial sectors can better contribute to the society than it has during recent years, and the European Commission must work to ensure this. In the scope of regulated financial sectors there must still be left room for diversity and healthy competition. The regulations adopted have mainly been designed to target large banks. Smaller actors, such as saving banks, might have faced disproportional requirements that have forced them to cut costs, merged and even close down, as mentioned above.

22) What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?

While opening up the possibility for SMEs to access funding more easily is a positive prospect, we must ensure that this development does not come at the detriment neither of EU investors nor investment seekers. By seeking investment abroad, SMEs open themselves up to the dangers associated with international investment. While these risks may be acceptable in some cases to get the economies of the EU to take off, domestic EU investment should be prioritized. This would both provide a more safe environment for SMEs to invest in and ensure that EU investment opportunities are not overlooked, which could potentially inhibit economic growth and thereby, i.a., further decrease the amount of employees working in the investment sector in the EU.

25) Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a capital markets union?

The main task of the ESAs, according to the ESA regulation, is regulatory work. Supervision of the banking sector is mainly done by the Single Supervisory Mechanism under the ECB. The ESAs have power to sanction and to coordinate the different national authorities, but they have no power of direct action towards market participants, as the ECB has. To give the ESAs the power to act directly towards market participants would give them an additional scope of action, which would be beneficial in light of their collective expertise in the field.

Please see our answer to Q 18.

28) What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?

It is important that the Commission does not only recognise possible obstacles, but also good and needed company law, including corporate governance. It is vital that the REFIT approach, or any other “better regulation” approach, from the Commission does not interfere with trade union and labour rights. Reducing the administrative burden is indeed a good idea in many respects, but rules protecting employees and promoting the role of social partners must not be undermined in the process.

Corporate governance rules and practices that should be promoted could for example be: whistle-blowing systems; rules to handle aggressive sales targets and merit rating systems; information, consultation and representation practices.

Several EU countries have employee representation in management boards or alternative systems of employee representation. NFU believes that this is beneficial from a corporate governance point of view as employees will often be able to add to the diversification of perspectives. In this respect, we also point at Recital 60 of CRD IV (Directive 2013/36/EU): *“Employee representation in management bodies could also, by adding a key perspective and genuine knowledge of the internal workings of institutions, be seen as a positive way of enhancing diversity.”*

It is NFUs view that the Single Market should not go to the detriment of employee representation, but rather result in higher standards.

Please also see our reply to question 13 in this regard.

While less directly related to the CMU, we are furthermore worried about possible side-effects of the SUP (Single Unius Personae), as the seat of a SUP should not necessarily be in the countries where the principal operations are. As such, to the extent that companies opt for establishing their seat in countries with less stringent labour legislation (or less stringent tax legislation...), there is a risk of a race to the bottom.

29) What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

The EU has followed the principle of minimum harmonisation for quite some time. Yet, if the EU wishes to arrive at a functioning single market, it needs to have fundamental rules fully harmonised. The question above, leads in the wrong direction. There is a very real possibility of added complexity in insolvency law, if the EU was to start harmonising individual aspects of insolvency law. What Europe would need is a complete European insolvency law of best standard. Workers’ and employees’ rights (wages, social contributions, etc.) need to be protected and get priority over other creditors as is the case in many countries of the EU already.

32) Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

A closer examination of how this opening up of the investment market will positively and adversely affect both the EU citizens and pensioners would be beneficial. Because, while the main aim of getting investment funds to the people and firms that need it is a noble one, potential hazards and drawbacks must receive equal attention as the positive aspects.

