Nordic Financial Unions

Olof Palmes gata 17 | 101 34 Stockholm

Contact: Arvid Ahrin | Deputy General Secretary

+46 708 522 443 | aal@nordicfinancialunions.org

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NFU Response to the Green Paper on the Long Term Financing of the European Economy

Summary of main points

- Diversity of credit supply and the fostering of long-term oriented investment should be sought within the confines of the regulated financial markets
- Banks should continue to be the key actor for providing long-term financing
- Development banks can help to reduce the risk in long-term investment but the financing should still be done mainly by regular banks
- Pension funds should not be required to promote certain societal goals at the behest of stable long-term returns; retirement funds are not government funds
- A level playing field in supervision must be ensured so as not to distort competition and to prevent the build-up of systemic risk
- Regulatory measures aimed at fostering long-term investment by the financial markets must not be a substitute for addressing the excessive austerity that is preventing a real economic recovery in Europe

General comments

NFU welcomes the Commission’s initiative to discuss the long-term financing of the European economy. The challenge is indeed, as the Commission states, to get the long-term financing process right in order to return to the long-run trend of economic growth.

However, there is a tendency that the Commission is now acts to remedy a problem (drop in investments) that at least in part can be caused by its own legislative agenda. The logic behind this move is thus unclear – burdened by new regulatory requirements the banks’ credit provision has gone down, and as a consequence, financing and capital has to be found elsewhere by outlining the right incentives and structures for other market actors. Banks should be allowed to continue to be the main providers of long-term financing.

This push to generate long-term financing outside of the regulated financial sector should not be used as an excuse to continue with the agenda of austerity that is one of the primary reasons behind the lack of a stable economic recovery in Europe. The task of investing in projects with wider public benefit that generate returns for society as a whole belongs primarily to governments, but the current austerity regime effectively prevents any lasting recovery to take place. The necessary financing for this should be raised and channeled on a level playing field of regulated financial markets.

Specific remarks

Question 1

Do you agree with the analysis set out above regarding the supply and characteristics of long-term financing?

The starting point for economic growth in Europe – and for the global economy for that matter – is well-functioning and sustainable financial sectors that serve the real economy. The prerequisite for a well-functioning and long-term oriented financial sector is regulation and supervision of as well as transparency in the sectors' practices and products. The financial crisis has proven beyond any doubt the need for better oversight, better regulation and a stronger capital base in the banks to secure financial stability as a foundation for sustainable growth.

Against this background, the European reform agenda for the financial sector is headed in the right direction. But there are inherent risks in the approach. An opaque financial market with lower competence and capital requirements is better than a regulatory reform that leads to credit supply being pushed out of the regulated, transparent and controlled part of the financial sector over to other market actors that lack the appropriate competence, local knowledge or capital strength (increasing the risk of imposing losses on taxpayers).

Diversity of credit supply and the fostering of long-term oriented investment should therefore be sought within the confines of the regulated financial markets. The American model, where a more or less unregulated shadow banking/market financing solution plays a far bigger role, should not be replicated.

Several aspects of the Green Paper give rise for concern.

- We do not accept the premise that the banks are to blame for the need to find alternative sources of finance for long-term investments. The solution should be found within the present model for bank financing.

- The Commission should be very cautious not to distort the market for credit supply, or put in other terms, be aware of which actors are being forced into the market for providing capital.
- An analysis must be made with regard to who carries, and can carry, the risk in the end.
- There is a need to analyse which actors that have the core competencies in credit assessments.
- A transparent and regulated market for credit provision must be ensured.
- There is need for a level playing field in the financial sectors, where all actors that provide credit and securitization are regulated and controlled in an equal manner to ensure financial stability, strengthen competition and safeguard growth in Europe.
- With regard to SMEs, the Commission should be aware of the fact that any attempt to force or distort competition might lead to negative consequences on the long term. Today's bank markets are transparent and well-functioning, and if other means of financing are forced through, it might give rise to a more opaque financial market.
- On a general note, it is not serious to address crowd funding in this context.
- With regard to securitization instruments, these were one of the main triggers of the financial crisis (cf. subprime loans).

Question 3

Given the evolving nature of the banking sector, going forward, what role do you see for banks in the channelling of financing to long-term investments?

Banks should continue to be the key actor for providing long-term financing. A forced diversification of credit provision risks challenging recent years' regulatory reform agenda by opening the market to new actors that might lack the appropriate competencies and knowledge, as well as operating with lower requirements on supervision, capital and regulation than do the banks.

Question 4

How could the role of national and multilateral development banks best support the financing of long-term investment? Is there scope for greater coordination between these banks in the pursuit of EU policy goals? How could financial instruments under the EU budget better support the financing of long-term investment in sustainable growth?

The role of the development banks could be to contribute to qualified credit assessments and to reducing risk in projects with implications for social development. This task should be carried out together with those financial actors that have the best expertise in assessing the creditworthiness of social and societal projects.

Potential social/societal development projects do, however, always carry with them certain risks. In relation to existing capital buffers at the time, too many loans were given to unprofitable projects in the run-up to the financial crisis, and it is this problem that is now being addressed by regulation that seeks to reduce risk and increase capital requirements. Banks have, however, by far still the best capacity to perform credit assessments, and it is therefore only natural for national and international development banks to cooperate with regular banks in this regard.

The Danish example of the development bank "Vækstfonden" (http://www.vf.dk/?sc_lang=en), a state-owned venture capital fund, is a telling example. The fund steps in and guarantees loans provided by financial institutions to social investment projects. By reducing the risk, the fund thereby enables financing to be channeled despite the increased risk carried by the lending institutions. At the same time, the banks assess the investments from growth perspective, and it is precisely this assessment that should form the backbone of system for long-term financing regardless of which actor that provide the credit. If development banks alone carry all the credit risk, the history of providing credit to too many unprofitable projects might repeat itself.

Question 6

To what extent and how can institutional investors play a greater role in the changing landscape of long-term financing?

As a starting point there is a need to analyse which barriers and obstacles to investments in for example infrastructure or sustainable energy that institutional investors themselves identify, keeping in mind the fact that it is more about channeling existing funds into long-term projects than raising new money from scratch.

Since pension funds have a long-term investment horizon it is of vital importance that they take economic and social sustainability into account. But it would be highly problematic if the pension funds would observe overall political circumstances at the behest of long-term returns of their investments.

With regard to financing of SMEs, it is quite unrealistic to assume that pension funds would contribute to that goal to any significant extent. Contacts with SMEs require a completely different corporate structure with direct customer contacts, which would be too costly to set up. The banks are already performing this task.

Whilst unnecessary obstacles to long-term financing from institutional investors such as pension funds should be removed, it must also be remembered that retirement savings are not government funds. Care should be taken not to expect pure profit-making from long-term societal investments made by public actors – experience shows that private enterprise is better at achieving this goal.

Question 7

How can prudential objectives and the desire to support long-term financing best be balanced in the design and implementation of the respective prudential rules for insurers, reinsurers and pension funds, such as IORPs?

Supervision should be carried out in the same way as for any other financial institution, with the aim of ensuring secure and stable activities. Supervision must not be compromised in order to achieve the objective of promoting certain forms of financing that are best accomplished via other means. Nor should the conditions for oversight be altered for some market participants whilst others are left within the regular supervisory framework – maintaining a level playing field of supervision must be the first priority.

Question 19

Would deeper tax coordination in the EU support the financing of long-term investment?

To have different taxation regimes for different parts of the financial sector in Europe is not optimal, since it distorts competition in a sector where the raw material (capital) is truly global in scope. National forms of taxation, such as the Danish tax on wages in the financial sector, can severely distort competition and not contribute to growth.

A tax on labour in the financial sector furthermore leads to a potential worsening of the quality of financial advice and credit assessment, as the tax gives the banks an incentive to reduce the number of employees working in the sector. A tax on wages in the financial sector will therefore, all other things being equal, reduce the amount of advice being given as well as credit assessments – two factors that are crucial for quality long-term financing. This does not mean, however, that we have a position on whether efforts should be made to adjust or coordinate corporate tax among EU member states, in this context relating to corporate tax rates.

Question 29

Would an EU regulatory framework help or hinder the development of these alternative non-bank sources of finance for SMEs? What reforms could help support their continued growth?

It is important that the Commission, in the discussion on decreasing administration costs and burdens for SME's, clearly acknowledges that labour legislation and collective agreements are not obstacles in these respects. Exempting employees in small companies from protection regulations in social legislation will increase the risk that these employees are treated arbitrarily and make it more difficult to recruit key personnel.

Question 30

In addition to the analysis and potential measures set out in this Green Paper, what else could contribute to the long-term financing of the European Economy?

The European Commission should work to put an end to the excessive austerity measures that are currently plaguing the European economy, preventing any stable long-term economic recovery. It is neither feasible nor serious to promote the establishment of a regulatory framework supporting long-term investment by banks and institutional investors without also pushing to revive the primary source of long-term financing, government money. Neglecting this key aspect of long-term financing whilst discussing regulatory measures that target a sector already heavily burdened by a plethora of new rules, is simply counterproductive. Measures should be drawn up promoting government investments that can support the real economy now and in the future, which in turn will only contribute positively to a stable and sustainable financial sector that can provide individuals and enterprises with the credit that they need.

About NFU

Nordic Financial Unions (NFU) is the voice of the employees in the Nordic financial sectors. We are an organisation for co-operation between trade unions in the banking, finance and insurance sectors of the Nordic countries. Through our eight affiliated unions in Denmark, Sweden, Norway, Finland and Iceland we represent 150 000 members – a vast majority of the employees in the Nordic financial sectors.

Yours faithfully,

NORDIC FINANCIAL UNIONS (NFU)

Michael Budolfsen	Christina J. Colclough
President	General Secretary