Response of :

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Public Consultation on

"Green Paper Long-term financing of the European economy (COM/2013/0150 final)"

European Commission
DG Internal Market and Services

Presentation of the ETUC

The European Trade Union Confederation (ETUC) is a trade union organization which was established in 1973 to represent workers and their national affiliates at the European level. Its role has increased as European integration has expanded EU influence on economic, employment and social policy throughout the 27 Member States.

The ETUC was established in 1973.

At present, the ETUC membership comprises 83 National Trade Union Confederations from a total of 36 European countries and 12 European industry federations, covering some 60 million individual trade unionists[1]. Other trade union structures operate under the auspices of the ETUC: EUROCADRES (the Council of European Professional and Managerial Staff) and EFREP/FERPA (European Federation of Retired and Elderly Persons).

The ETUC's mission is to bring about a united Europe of peace and stability, where working people and their families enjoy full human, civil, social and employment rights and high living standards. To achieve this, it promotes the European Social Model, combining sustainable economic growth with ever-improving living and working conditions, including full employment, social protection, equal opportunities, good quality jobs, social inclusion, and an open and democratic policy-making process that involves citizens fully in the decisions that affect them.

The ETUC regards workers' consultation, collective bargaining, social dialogue and good working conditions as key to achieving these objectives and promoting innovation, productivity and growth in Europe.

The ETUC exists to represent the European trade union movement at EU level. It works with the other European social partners (representing employers) and the European institutions to develop employment, social and macroeconomic policies that reflect the interests of workers throughout Europe.

Since 2002, the ETUC has further expanded its role in EU-level industrial relations, promoting the development of an autonomous social dialogue between workers' and employers' representatives. The social partners have concluded 'autonomous' agreements on :

- telework (2002)
- work-related stress (2004)
- harassment and violence at work (2007)
- inclusive labour markets (2010)
- a framework of actions for the lifelong development of competencies and qualifications (2002), and a framework of actions on gender equality (2005).

The ETUC is the main counterpart to the EU institutions when it comes to representing workers at EU level. Together with the other European social partners, the ETUC works with all the EU governing bodies: Presidency, Council, Commission and Parliament. Its right to

[1] The list of countries represented is available on this link: http://www.etuc.org/a/109

represent the interests of European workers in the formulation of EU employment, social and macroeconomic policy is articulated in the EU Treaty. The ETUC:

- takes part in the annual Tripartite Social Summits;
- draws up the trade union response to European Commission proposals;
- liaises with a cross-party Intergroup of MEPs in the European Parliament;
- coordinates trade union participation in a number of advisory bodies, including the Economic and Social Committee and the EU agencies for vocational training (CEDEFOP), improvement of living and working conditions (Dublin Foundation), and health and safety Agency (Bilbao).

At the biannual meetings of the Macroeconomic Dialogue (MED), established in 1998, the social partners discuss economic policy with the EU Economic and Financial Affairs Council (ECOFIN), the European Central Bank (ECB), and the Commission.

The ETUC also pursues its campaign for Social Europe through direct action, such as Euro-demonstrations (for example against the Services Directive), and other campaigns. In this way the ETUC takes a lead in important social and employment issues of relevance to all Europeans.

ETUC-affiliated trade union organisations maintain their own decision-making procedures. Delegates from the member organisations decide ETUC policies and activities at European level democratically, and the ETUC itself does not have a mandate to impose a line on national confederations. The ETUC also has its own democratic structure.

The ETUC coordinates the activities of the 41 ITUCs (Interregional Trade Union Councils), which organise trade union cooperation across national borders in the EU. The ETUC is recognised by the European Union, by the Council of Europe and by the European Free Trade Association as the only representative cross-sectoral trade union organisation at European level.

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

The ETUC concurs with the Commission's opinion that there is a serious shortage of long-term financing available for the considerable investment needs that exist in areas such as the energy, water and transport infrastructure and the ecological modernization of industry and buildings. The ETUC also believes that the costs of training and education should be treated as long-term investments. The shortage of long-term financing is, however, much more complex than just an issue of supply and demand, as it involves the issues of the profit expectations and liquidity preferences of investors as well as the investment channels available for long-term investment. Many of the long-term investments mentioned above have considerable benefits for society as a whole, but offer investors a rate of return below the rates available for other common types of investments (the so-called problem of 'positive externalities'). Conventional private mechanisms do a poor job of financing these types of investments. Thus governments need to take the lead in finding appropriate vehicles for financing these types of investments. In general a public role will be quite important as much of the returns of these investments will be captured by society as a whole rather than investors. Here the ETUC would like to note that the misallocation of resources through financial markets and the excessive emphasis on short-term and speculative investments is a problem which preceded the financial crisis.

2) Do you have a view on the most appropriate definition of long-term financing?

Long-term financing involves the provision of capital for investment purposes for a multi-year period. Certainly investments with a maturity of five years or more would count as long-term investments. The ETUC would however disagree with the G20's narrow focus on maturities. For example, although publicly-traded equity generally has no specific maturity, holding periods of equity by speculative investors can be as short as milliseconds. Thus the definition of long-term financing also needs to include the time horizon of the investor as well as the stability and predictability of the conditions under which this investment is provided.

The scope of the Green Paper appears therefore rather heterogeneous and broad, as an example infrastructure financing and SME financing do not have much in common, requiring very different time horizons and generating very different risks. For instance it is questionable whether SME financing should be classified as long term given average maturity of SME loans between five and seven years. While both are important for growth and job creation, related policy actions may risk putting together a heterogeneous catalogue of measures without a clear focus.

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?

The Green Paper starts from the assessment that bank long term lending will decline and that we thus need to promote alternative channels of long term financing. We believe however that bank lending should not be so easily dismissed. Although many banks, particularly those in countries most affected by the crisis, are seriously impaired in their ability to provide financing, in the long-run the banking sector will remain the primary source of long-term financing for companies (particularly SMEs) and households. Here it should be noted that securitization and the corresponding weakening of 'relationship banking', which involves one-to-one relationships between banks and borrowers, was one of the contributing factors for the crisis, since long-term responsibility for risk was diffused along the securitization chain. Although financial markets will remain important for certain borrowers (e.g. governments and large companies), steps should be taken to strengthen the banking system and the ability of banks to access long-term refinancing to cover their long-term investments. Corporate governance in the banking sector is also a key issue, as cooperative and public savings banks have shown a strong commitment to providing long-term financing to SMEs and households. Thus financial regulations need to respect the needs of these banking segments.

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 ETUC shares the view of the Commission that the role of national and multilateral development banks in supporting the financing of long-term investment should be enhanced. At EU level, project bonds of the EIB and a much larger capitalized European Investment Fund could finance both larger cross-border projects as well as infrastructure investments in countries under fiscal strain. The current threshold for EIB funding is of concern however, since it restricts access to EIB funding for SMEs. The ETUC therefore recommends that the EIB set up a special branch for SME funding with tailor-made loan conditions.

The ETUC does however not see a risk in development banks crowding-out private banks' funding of long-term investment. More likely the opposite has been the case. In practice, many targeted programmes with favourable refinancing conditions from the (public) development banks that belong to the Long Term Investors Club (LTIC) have not been provided to clients by the (private) banking sector, with the latter favouring their own loan conditions.

Outside the euro area, in cases of credit crunch and where development banks do not exist, central banks such as the Bank of England, the Hungarian National Bank, have stepped in to provide credit to the corporate sector, in particular to SMEs, via targeted ‚funding for lending' programmes channelled through commercial banks, since and while the latter have embarked on deleveraging their balance sheets.

5) Are there other public policy tools and frameworks that can support the financing of long-term investment?

First and foremost, a system of broad-based financial transaction taxes would bring about largely beneficial effects for the real economy in favouring long-term over short-term investments, since high-frequency trading of assets and 'churning' would become more costly.

Secondly, a second phase of pro-active regulation of financial markets with a simpler market structure going beyond the repair work of prudential regulation undertaken so far. This implies, among others, separating investment banking from commercial banking and a controlled reduction of balance sheets of the largest financial institutions to the benefit of their loan portfolios.

Thirdly, a clear and accountable EU framework of infrastructure projects to modernize the capital stock of public goods. A clear and consistent public strategy on project finance would help creating a pool of assets for long term investors.

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

Institutional investors such as pension funds or insurers do already play an important role in financing long-term projects, even more so when they are bound to rely on the safety and stability of their investments. A significant increase of EIB programmes, including project bonds, and of the European Investment Fund could provide significant long-term investment opportunities for institutional investors.

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?

The ETUC welcomes the recent announcement by the Commission that it will not pursue new prudential regulatory standards for pension schemes in the forthcoming review of the Directive on Institutions for Occupational Retirement Provision (IORP). This will provide further opportunity for analysis and reflection on the best approach.

Regulation and supervision of pre-funded pension providers/funds of the third pillar must continue limiting short-term and risky trading and at the same time must channel savings into long-term investments such as infrastructure. Investing in shares and private equity funds does not necessarily provide a long-term horizon, given the price volatility of the former and the normal holding periods of four to five years of the latter.

8) What are the barriers to creating pooled investment vehicles? Could platforms be developed at the EU level?

See answer to question 6 above.

9) What other options and instruments could be considered to enhance the capacity of banks and institutional investors to channel long-term finance?

…

10) Are there any cumulative impacts of current and planned prudential reforms on the level and cyclicality of aggregate long-term investment and how significant are they? How could any impact be best addressed?

Lobbyists from the financial sector have been issuing warnings against purportedly negative externalities of financial reform since the very start of the EU reform agenda in 2009. More lately, the same vested interests have turned against so-called 'cumulative effects' of financial reform. While complaints against the complexity of recent regulations and the number of detailed exemption clauses may be legitimate, the **level** and quality of prudential reforms does not per se constitute obstacles to long-term investments.

The ETUC rejects the notion of regulatory over-burden as pure propaganda and believes that a sea change in the behaviour of finance is far from being put in place. A real retrenchment of excessive betting and trading activities is a pre-condition for re-orienting finance towards the long-term.

11) How could capital market financing of long-term investment be improved in Europe?

In addition to answers given to questions 5) and 6) above, a regulatory framework that reduces capital market volatility to a minimum and provides for a slowdown of financial market turn-over could contribute significantly to channelling finances to long-term investment.

12) How can capital markets help fill the equity gap in Europe? What should change in the way market-based intermediation operates to ensure that the financing can better flow to long-term investments, better support the financing of long-term investment in economically-, socially- and environmentally-sustainable growth and ensuring adequate protection for investors and consumers?

The ETUC agrees with the European Commission's assessment of the causes of the equity gap in Europe, which include a shift of pension funds towards defined contributions, stock exchange business models, the preferential tax treatment of debt over equity, changes in regulatory incentives and the growth of alternative investment funds.

Some of these elements are of temporary nature: a weak economic outlook tends to discourage instruments with an unlimited return potential such as equities and at the same time encourages a flight to the safety and quality of sovereign bonds. Other elements are structural and require some key changes.

Equity instruments have many potential benefits and if used properly can promote accountability, a sense of ownership and lower leverage while providing unlimited upside to investors. As they are perpetual instruments, they are potentially good tools for companies to make long term decisions, provided that shareholders take a long term view of the company.

The ETUC therefore supports the proposals of removing the tax bias favouring debt over equity and addressing suboptimal market behaviour.

In particular the focus on maximising short term shareholder value and the dictatorship of smooth earnings are linked to a short-sighted and limited conception of risk and should be addressed. Something is deeply wrong with capital markets when companies are willing to trade-off economic value against earnings matching analysts' forecasts.

This comes from a conception of risk that doesn't differentiate adequately between volatility of earnings linked to the normal business cycle and risk coming from structurally declining earnings, that also doesn't differentiate adequately between volatility of stock prices and “failure of investments to meet the reasonable expectations of savers”, and that focuses more on relative performance to a short term benchmark and less on fundamental value.

The large growth in financial intermediation also compounds the problem. Addressing these issues requires taking action on several fronts, including governance arrangements, regulatory incentives, a rethinking of the interpretation of the fiduciary duty and tax incentives (for more details on this, see answers to questions below).

Governance changes include new asset allocation frameworks for institutional investors that are more focussed on the fundamental drivers of risk and return, corporate executives' compensation arrangements that incentivize horizons longer than their (sometimes short) employment, increasing corporate boards' sense of ownership, reducing financial advisors' incentive to promote instruments with a high turn-over potential, and last, but not least, the degree of employee involvement and worker participation in firm management, including at board level.

Regulation has a key role to play by differentiating adequately between buy and hold investments and trading, and between risk and volatility of asset prices. It should also take action to simplify financial intermediation chains and further align interests between intermediaries, borrowers and lenders.

13) What are the pros and cons of developing a more harmonised framework for covered bonds? What elements could compose this framework?

While covered bonds have proven fairly resilient during the crisis and while they are less vulnerable to principal-agent problems than securitisation, they provide limited benefits due to their impact on asset encumbrance.

While the ETUC would recognize the benefits provided by collateralised funding when there is a crisis of confidence, we would find it unsound to promote a normalised use of collateralised funding at all times, since it is important to remember that finance, capital markets and lending are about trust, and validating instruments based on absence of trust would be a very dangerous development with important unintended consequences going beyond the current decline of unsecured funding.

It would therefore be healthier to act more decisively on restoring confidence and a lot is yet to be done in that area.

As an example of possible actions, the crisis has evidenced the damage that can be inflicted by solvency concerns on financial institutions. Solvency concerns can be based on actual solvency issues but also on investors' perception of solvency issues, which is often irrational and exuberant. While the former can be addressed through higher capital requirements, addressing perception is more difficult and requires improved transparency, accountability and credibility of solvency measures.

In this respect, the ETUC believes that the recent CRD IV/CRR package will have an only modestly positive impact on solvency but unfortunately a very weak impact on perceptions: while banks' regulatory capital will increase, leverage will still remain unconstrained, and the transparency of banks' regulatory capital and solvency will not improve.

Therefore while the ETUC recognizes the benefits of covered bonds, we are not convinced that promoting this instrument via a harmonization of the European framework is a promising direction.

14) How could the securitisation market in the EU be revived in order to achieve the right balance between financial stability and the need to improve maturity transformation by the financial system?

Despite having been at the heart of the 2007 crisis, securitisation is not a bad tool per se, and, if done properly, can provide a useful alternative source of funding. Therefore the answer to the question of whether it is desirable to revive the securitisation market in the EU has to be nuanced, as the devil is in the details.

As an example, the decline of securitisation done for regulatory arbitrage purposes or without effective transfer of risk is a good thing and should not be revived. The stated objective to balance financial stability and the need to improve maturity transformation by the financial system are not necessarily contradictory: indeed improving maturity transformation is good for financial stability. If question 14) implies shifting maturity transformation from banks to securitisation, then it is important to remember that maturity transformation poses equivalent risks in banks and non-banks. The ETUC would however agree with developing a form of securitisation with very limited maturity transformation through issuing long term securities sold to long term investors.

There is also a number of problematic issues with securitisation that need to be addressed, including flawed or inexistent credit risk transfer such as sovereign CDS's, principal-agent problems all along the chain, asset encumbrance, excessive reliance on ratings, increased interconnectedness, unrestrained leverage, risk assessments that overweight quantitative elements and bank support over the quality of the underlying asset pool, and asymmetry of information compounded by a lack of transparency about the underlying assets.

Amongst these, the quality of the underlying pool of assets is one of the key elements: while securitisations with sound assets have usually done well through testing times, the decline in the quality of the pools and securitisation of non-typical assets pre-crisis was a major factor in the problems that ensued. Securitisation is especially vulnerable to these risks since this technique enables almost any asset to be made to look attractive and safe.

In this respect industry initiatives such as quality labels can be a step in the right direction. In particular, transparency and simplicity standards providing investors with more detailed data at loan level and cash flow models, and requiring the disclosure of credit enhancement mechanisms are very good proposals. They should enable investors to make better risk assessments, reduce reliance on external ratings and incentivize sound underlying assets.

The ETUC also welcomes quality standards that exclude re-securitisations and synthetic securitisations while including independent third party reviews of the originator's general portfolio from which the underlying assets were selected.

The ETUC believes nevertheless that the following conditions must be met for the quality labels in order to address all the issues above:

For the purpose of this initiative, the list of eligible assets that should be promoted in "good" securitisations should focus on long term productive investments where there is an identified shortage of funding. In this respect, quality labels' eligible assets seem to focus instead on non-productive assets with the exception of SME loans, and do not include long term productive assets such as infrastructure. Instead they include non-productive assets that are prone to bubbles and where there is no shortage of funding, such as residential mortgages. This raises the question of whether regulators should include such labels in the regulatory response to the long term funding gap.

The quality labels do not seem to include any criteria on maturity transformation, whereas as stated earlier one of the main objectives of developing non-bank lending should be to reduce maturity transformation in the system.

Additional lending rules including qualitative elements should also be used, especially for SMEs, to ensure the homogeneous quality of the loans, and should be disclosed to investors.

Rating agency methodologies are currently too focused on whether the underlying asset pool benefits from a full or partial support, and not enough on the quality of the underlying pool, it would be beneficial to require CRAs also to provide ratings that do not take into consideration possible support. We believe as well that for reasons of conflict of interests, CRAs should not be allowed to collaborate with issuers to help them get the best ratings.

For better transparency, the ETUC believes that additional measures should be taken such as disclosing separately data on different types of underlyings, in the case of conduits bundling together very different types of assets.

The ETUC is critical of industry initiatives without a generalized set of rules for all. These initiatives have limits, since participation is voluntary and neither industry initiatives nor market discipline prevented the current crisis. There is also a need for regulators to monitor and restrain the possible related systemic risks such as leverage, interconnectedness and the build-up of unrealistic assumptions in the system, since non-bank lending is not subject to the same capital, leverage and transparency requirements as is bank lending. The ETUC believes that a two-tier system of regulation may create the wrong incentives, and that at the very least equivalent restraint on leverage is required.

15) What are the merits of the various models for a specific savings account available within the EU level? Could an EU model be designed?

Some national savings accounts models, such as the Livret A in France, are destined to refinance long-term investment. It would appear difficult though to generalize this at EU level. An EU savings account would have to bring about additional value added in order to be able to compete with national schemes and there will probably be a number of technical problems, e.g. related to tax regulation and related whether countries belong to the euro area while others do not. There are probably other instruments that would be more suitable to promote the objectives of the green paper.

16) What type of CIT reforms could improve investment conditions by removing distortions between debt and equity?

The Commission Action Plan to strengthen the fight against tax fraud and tax evasion, if properly implemented, as well as the current debate to close tax loopholes and to restrict access to tax havens in the EU, should provide a number of EU member states with increased tax revenues without making changes to the existing tax rates. In any case, CIT rates should not be cut further in the false expectation that tax cuts would incentivise companies to invest more. On the contrary, everything should be done to harmonize the corporate tax base and to move towards minimum CIT rates at EU level.

The ETUC believes furthermore that tax deductibility on debt interest should be reformed. We argue that a distinction should be made between debt that is used to fund investment for organic growth and debt used for acquisitions, and that tax deductibility should be limited to the former. We have suggested that scale or ratio of debt to pre-tax profits (or some other measure) could be used as a proxy for this (and would certainly serve to limit the extent of leverage which is effectively being subsidised by the tax payer).

17) What considerations should be taken into account for setting the right incentives at national level for long-term saving? In particular, how should tax incentives be used to encourage long-term saving in a balanced way?

The ETUC does not share the neo-classical view that savings are a pre-condition for investment, at least not for the corporate sector. Companies invest first and foremost when they see opportunities for profitable returns, a pre-condition for which is sustainable demand. The current situation however – five years into the crisis – is characterized by a lack of both public and private household demand. Tax based or other incentives for further savings would therefore be both pro-cyclical and counterproductive, since too many agents are faced with the need of deleveraging.

18) Which types of corporate tax incentives are beneficial? What measures could be used to deal with the risks of arbitrage when exemptions/incentives are granted for specific activities?

See response to question 16 above.

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

Yes. The Commission has acknowledged the regulatory effects of Financial Transaction Taxes to favour longer-term investments by making high-frequency, short-term and extremely speculative investments more expensive. The introduction of financial transaction taxes over and beyond the enhanced cooperation procedure would certainly help to disincentivizing short-termism in financial markets.

20) To what extent do you consider that the use of fair value accounting principles has led to short-termism in investor behaviour? What alternatives or other ways to compensate for such effects could be suggested?

Fair value accounting principles contribute in general to a short-term, pro-cyclical orientation of investors and were a contributing factor to the financial crisis. Financial markets are prone to cyclical swings between over- and under-valuation of financial assets. Thus, orienting the valuation of the asset base of financial and non-financial companies to financial market values will overvalue this asset base during 'euphoric' market phases and undervalue this asset base during 'pessimistic' market phases. When the lending capacity of banks and the financial rating of non-financial companies are subject to this type of valuation, strong incentives for pro-cyclical behavior result. Alternatives to fair value accounting such as historical cost accounting should be considered.

21) What kind of incentives could help promote better long-term shareholder engagement?

The ETUC has taken the position that long-term investors should enjoy a privileged position vis-à-vis short-term investors in the governance of companies. Much shareholder engagement, e.g. through activist hedge funds, is in fact short-term oriented, for example in the attempt to extract special dividends from companies. Voting rights on shares should only be provided to those who have invested in these shares for a longer period of time. Improving the transparency of the shareholder base and requiring institutional investors to disclose their share voting policies and voting records would also be positive supporting measures. Finally, other types of incentives, such as double dividends and preferential capital gains tax rates for long-term share investments and a financial transactions tax, could help discourage short-termism on stock markets.

22) How can the mandates and incentives given to asset managers be developed to support long-term investment strategies and relationships?

The evaluation and reward of asset managers on the basis of annual or even quarterly performance relative to benchmarks is one of the causes of the strong short-term orientation on financial markets. The evaluation and reward of these asset managers needs to include a multi-year component as well as alternatives to simple benchmarking, including the use of risk-adjusted and absolute performance metrics. In general, transparency in the parameters of mandates and incentives along the investment chain are needed.

23) Is there a need to revisit the definition of fiduciary duty in the context of long-term financing?

Fiduciary duty should be more clearly defined to allow both the consideration of risk-adjusted measures of performance as well as the social and ecological consequences of investments.

24) To what extent can increased integration of financial and non-financial information help provide a clearer overview of a company's long-term performance, and contribute to better investment decision-making?

In general there is a growing demand from society and investors for the provision of non-financial (ecological, social and governance) information by companies. The ETUC has spoken out in favor of a requirement for the provision of non-financial information by companies, including integrated reporting which would in principle put non-financial reporting on the same footing as financial reporting. However, more important than integrated reporting for the comprehensiveness, comparability and credibility of this information is: 1) the definition of clear and mandatory standards for non-financial reporting, so companies do not 'pick and choose' amongst the alternatives they find most convenient, and 2) the credibility of this information, for example through external auditing and through a trade union role in the enforcement of labor standards through supply chains.

25) Is there a need to develop specific long-term benchmarks?

In light of the discussion above, it would be important to define long-term benchmarks which include both risk-adjusted measures of performance and non-financial criteria. Current practice is to evaluate and reward asset managers on the basis of short-term (annual or even quarterly), non-risk adjusted performance relative to a financial index. Benchmarks should include both the risk level and the nonfinancial performance/sustainability of the underlying assets invested in. A serious problem in the area of nonfinancial performance is the lack of standardization in the definition and measurement of specific types of ecological and social performance.

26) What further steps could be envisaged, in terms of EU regulation or other reforms, to facilitate SME access to alternative sources of finance?

In light of the answer to question 3) above, the most helpful measure for strengthening SME access to long-term finance would be to strengthen the banking sector, including cooperative and public savings banks, particularly those segments committed to lending to SMEs. In addition to strengthening these segments, improved access for banks to long-term refinancing for long-term investments in SMEs would be helpful. The suitability of and demand for alternative sources of financing, e.g. venture capital, will be limited to a very small minority of SMEs. Thus promoting these alternatives will not benefit the large majority of SMEs.

27) How could securitisation instruments for SMEs be designed? What are the best ways to use securitisation in order to mobilise financial intermediaries' capital for additional lending/investments to SMEs?

Given the responses to questions 3) and 26) above, it is questionable whether securitization would be a preferred alternative relative to a strengthening of the banking system, particularly of those segments committed to 'relationship banking' with SMEs. At the very least, a substantial proportion of the original loan and clear responsibility for the risk on the loan should remain with the originating bank. As an alternative, the market for the issuance of long-term bank bonds could be improved. Here banks (including small banks) can raise long-term finance on capital markets, and use these funds to invest long-term in SMEs. The loans to SMEs would however remain on the books of the originating bank.

28) Would there be merit in creating a fully separate and distinct approach for SME markets? How and by whom could a market be developed for SMEs, including for securitised products specifically designed for SMEs' financing needs?

See answer to question 27) above. Also note that, unlike large companies, SMEs are very dependent upon the advisory services of the 'house bank', thus there is an additional argument in favor of strengthening rather than weakening 'relationship banking' for SMEs.

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

See answers to questions 27) and 28) above. In the context of improving the market for long-term bank bonds or long-term refinancing for banks, specific EU measures could in principle be helpful.

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?

No comment