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THE DIRECTOR GENERAL

Mr Valdis Dombrovskis
Vice-President
Euro & Social Dialogue
European Commission
Rue de la Loi 200
B-1049 Brussels
BELGIUM

14 March 2017

Dear Vice-President, Dear Valdis,

Capital Markets Union: Mid-Term Review

As you know, BusinessEurope strongly supports implementing a comprehensive Capital Markets Union. We have to enlarge and deepen EU capital markets, help companies to access diversified funding sources, strengthen cross-border capital flows and reinforce the resilience of the Euro Area to a-symmetric shocks. We are therefore looking forward to the publication of the Mid-term Review of the Capital Markets Union (CMU) Action Plan later this year.

Previously, BusinessEurope set out five key areas under which EU policy makers need to take action to create a CMU.

- We need to **improve information flows** regarding growth-prospects for small and medium-sized companies;
- we need to ensure that **prudential rules** strike the right balance between increasing financial stability and supporting companies' need for capital for investment;
- we need to develop **complementary sources of finance** to bank lending;
- restore confidence in **securitization**; and, lastly,
- promote tax systems which **support equity** financed investment.

These objectives remain valid and we refer to our earlier submissions, especially our input from last year to the Call for Evidence, for more details.

We would like to commend the Commission for having taken relevant steps to achieve several of our key objectives even though we have some concerns about some of the different legislative proposals (and subsequent amendments). These concerns have been, and will be, addressed by us in the context of the legislative proposals in question.

The need for progress and the role of banks

Overall, we need more progress, especially regarding venture capital, debt and equity financing, and also securitisation, not only for the benefit of large, and growing medium-sized firms, which are most likely to benefit from a CMU, but also SMEs, which will mostly continue to rely on (local) bank loans.

Consequently, we have to carefully check how banks fulfil their task of financing the real economy, especially in view of new bank rules which affected bank's lending ability.

Assess cumulative effects and impact of Brexit

We still need a comprehensive impact assessments of the combined effects of financial legislation on access to finance and the European economy. Not just separate assessments, such as the one that has been carried out for the newly proposed prudential rules for banks (CRR/CRD V) and which focuses on the effects on bank financing. But also of the interaction of these rules with the whole spectrum of other financial reform measures, focusing on the effects on European financial markets as a whole. First steps have been taken in the follow-up from the 2015 Call for Evidence but we still need a satisfactory analysis of the combined effects of all the different reforms.

This analysis should also look at the effects of new accounting rules on how banks account for loans and also take account of some Brexit scenarios as the Brexit by itself changes the dimensions of the CMU approach, whatever the outcome of the negotiations will be. It will require in each Member State a deepening and an enlargement of capital markets which allow EU financial institutions to grow and compete on a level playing field, encourage innovative financing, and enable investors (such as banks, insurance companies, and private equity) to finance companies on the various maturities and especially long-term.

Risk mitigation

There is another element of financial regulation that is of particular importance to us and that is the ability of non-financial companies to hedge risks, for example related to currencies or raw materials. We have seen that implementing legislation of the capital adequacy rules, securities rules (MiFID) and the derivatives rules (EMIR) has an effect on the use of derivatives by non-financial companies to hedge risk because it discourages banks to offer these services. The Commission is planning to review EMIR and it is vital that this review does not affect the existing hedging definitions and clearing exemptions for non-financial companies. We further reiterate that the corresponding exemption for (uncollateralised) corporate derivatives from CVA charges in CRD IV has to be upheld. We should ensure that no new burdens are created that could undermine effective risk-mitigation.

Banking Union and the problem of Non-Performing Loans

The Commission rightfully mentions in its 20 January working document that the CMU and the Banking Union reinforce each other. The successful integration of these two policy priorities is, in fact, essential for restarting lending to the economy. We have to put in place a full banking union - meaning its three pillars of supervision, resolution and deposit schemes - to address the continued fragmentation of EU savings and credit markets. We also need a comprehensive strategy to solve the high levels of non-performing loans (NPLs) in many European banks that addresses existing market failures and regulatory uncertainty. NPLs account for about 5% of bank lending in the Euro Area, well above the pre-crisis level of below 2%. ECB analysis suggests that if the capital tied up to support NPLs could be deployed to support new lending, total credit volume in the Euro Area could increase with at least 2.5% overall, and at least 6% in the six Member States with the highest concentration of NPLs.

Specific policy issues

Lastly, in relation to the actions listed in the working document, we would like to highlight some aspects that are of particular concern to us.

Regarding the goal to strengthen **feedback given by banks** which decline credit applications, we recommend sharing the results of the work regarding the development of high-level principles in this area. Business associations should be able to look after their interests in this context as it is vital that companies, and not only SMEs, are aware of their credit risk evaluation and receive feedback rapidly and in an easily accessible way.

Regarding the development of **pan-European information systems** for SMEs, we support that existing national (or international) platforms/communities that already represent best practices, should be enhanced through the CMU in order to promote efficiency and avoid disproportionate costs.

Regarding the goal to develop an overarching strategy on **sustainable finance** as part of the CMU, we would like to warn against further legislation on corporate governance which would undermine existing voluntary codes and schemes that are based on a comply and explain approach. Although appropriate company law and corporate governance arrangements also play a role in encouraging institutional and other investors to provide capital to companies, it should be avoided that these rules impose unnecessary burdens on companies and investors such as overly prescriptive disclosure obligations. In this context, we are very concerned about the disclosure of sensitive information following the implementation of public Country-by-Country reporting requirements as this could undermine EU businesses' competitive position.

Similarly, regarding **taxation**, BusinessEurope believes a CCCTB has the potential to support growth, but putting in place a CCTB (i.e. without consolidation and mandatory for large businesses), will raise costs, without providing competitiveness benefits. The proposed measure to address the debt/equity issue also raises concerns as adding a reduction of equity capital to taxable income, introduces an unwarranted cyclical element to corporate taxation, which may result in a higher tax bill during economic hardship.

Although BusinessEurope is generally supportive of a restructuring approach to insolvency and of a second chance which takes proper account of the interests of creditors, further harmonization in complex areas relating to insolvency, tax and corporate governance should be considered as longer-term challenges. Rushing actions in these areas as part of the CMU could risk delaying the overarching objective of boosting investment for firms across Europe.

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In order to create growth and jobs, businesses need stability and regulatory certainty. The EU and its Member States should carefully assess the need for, and impact of new legislation, to focus on cumulative effects and the bedding-in of the reforms of recent years. A higher degree of consistency between regulatory measures is essential to ensure investment and a proper functioning CMU.

We hope that you share these concerns and that future financial regulation work will ensure that the legislation functions effectively, encouraging growth and preventing damage to businesses in the wider economy.

We remain at your disposal should you wish to discuss these issues further.

Yours sincerely,

Markus J. Beyrer