A Capital Markets Union for Europe

WE WELCOME THE EUROPEAN COMMISSION'S FOCUS ON JOBS AND GROWTH IN EUROPE AND ITS COMMITMENT TO DEVELOP A CAPITAL MARKETS UNION TO CONTRIBUTE TO ACHIEVING THIS VISION.

We believe that the Capital Markets Union should be an ambitious programme to build the appropriate ecosystem for greater market financing in Europe.

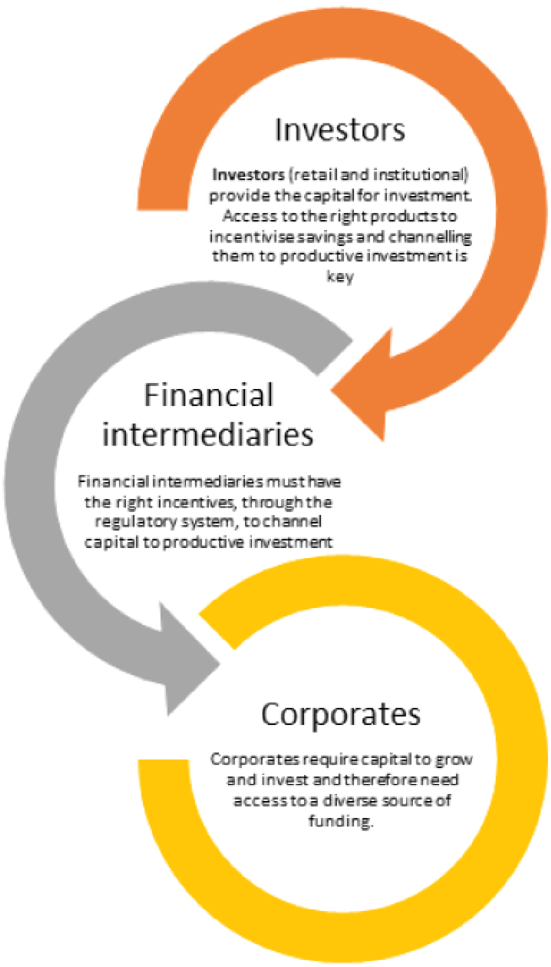
Introduction

While the ambition of creating a Capital Markets Union in Europe is an aspiration we all share, finding the appropriate policy levers to achieve this will be critical. Optimising and reinforcing the coherence of the existing European regulatory framework to achieve balance between the twin goals of stability and competitiveness is important. But we need to go beyond this: we need a radical shift in our investment culture if we are to develop a true Capital Markets Union in Europe. The focus needs to be on areas that are achievable and can deliver real impact.

That said, we also need to be realistic about what can be achieved. Firstly, a certain amount of fragmentation will always persist given the very nature of the European Union with 28 Member States and 23 official languages. Secondly, a Capital Markets Union can facilitate growth but will have a limited effect, given the current extraordinary monetary conditions, without fixing the macroeconomic situation in many European countries.

While it is important to be pragmatic and focus on tangible actions that can deliver results by 2019, we must also begin laying the groundwork for more ambitious reforms to create a truly Single Market for Capital in Europe. Therefore, this paper considers priorities both for the short, medium and long-term.

In examining the questions of how to improve capital markets financing in Europe, we also need to consider the three constituencies – investors, financial intermediaries and corporates – as well as the value chain linking them together.



A Capital Markets Union should facilitate **access to diversified sources of finance and optimised cost of capital for corporates of all sizes, but in particular for mid-sized companies.**

It must **also provide attractive products for investors, both retail and institutional**, to invest in the European economy while maintaining high levels of investor protection.

The **role of the financial services sector is to bridge the gap between these two constituencies** by efficient intermediation, thereby ensuring the efficient allocation of capital.

It is only by addressing the needs of, and barriers affecting, all three of these distinct groups that we can reduce fragmentation in the EU financial markets.

Objectives of a Capital Markets Union

The overriding ambition of the Capital Markets Union should be to improve the competitiveness of Europe in the global economy.

In setting out our vision for a Capital Markets Union, we consider that there are three objectives against which the success of any Capital Markets Union must be measured:

- **Increasing the overall amount of capital within the market-based financial system**
- **Improving the efficient allocation of capital across the EU towards long-term finance**
- **Financial stability**

Capital Markets Union should facilitate access to diversified sources of financing and the best possible cost of capital for corporates of all sizes. At the same time, it should provide a credible path towards long-term financial stability and security for European citizens.

While we cannot expect to replicate the US model, it does act as a useful barometer of what can be achieved in this area. Measuring movement over time away from the current 70:30 bank to capital markets financing ratio could be a useful metric for measuring progress.

To achieve this, we need a combination of optimised regulation, convergent supervisory practices, the emergence of a competitive system of market infrastructures, as well as healthy over-the-counter markets, business best practices and a broad range of financial instruments.

Key themes

In thinking about the challenges facing the EU in developing a Capital Markets Union, three key themes emerge that warrant further work at a horizontal level:

- **How to calibrate the risk appetite of both corporates and investors in Europe**

Risk is the trigger for growth and corporates are typically risk generators in an economy. However, in recent years, companies have become increasingly risk averse, preferring to maintain large cash buffers and limiting their investment. While this is largely down to the current macroeconomic climate, some structural issues may also explain this phenomenon. On the other side of the coin, investors are also risk averse and the EU lacks a strong hedge fund and private equity market to provide the risk capital required.

Furthermore, we need to assess whether the current regulatory framework impedes corporates and investors from managing their risks efficiently.

- **ACHIEVING SCALE: THE ROLE OF CONVERGENCE, CONSOLIDATION AND COMPETITION IN DEVELOPING A COMPETITIVE FINANCIAL SECTOR IN EUROPE**

Liquidity and efficiency are key drivers in robust and developed capital markets. In order to produce deep pools of liquidity and to enable efficiency it is essential to develop critical mass and to capitalise on economies of scale.

This can take two forms:

- Economies of scale at the product level;
- Economies of scale at the institutional level.

Developing scale at product level

Developing scale at a product level can be achieved through greater convergence of products and processes. For example, the International Capital Markets Association has been developing standards for European private placements. Work is also going on within the industry to "industrialise" other products and market segments, including in the area of municipal bonds, green bonds and securitisation.

There are numerous other areas where greater convergence may be helpful, such as in the corporate bond market. The market is currently fragmented and new issue practices have contributed to a market structure that is inherently illiquid. Standardisation of certain features of large new corporate bond issues (over €500m) would reduce the number of bonds and increase their liquidity. The majority of institutional investors will buy such instruments with the intention of holding them to maturity, but the existence of a secondary market would give them the ability to rebalance their portfolios where necessary, potentially making it easier for them to invest in the first place.

It is important, however, that any change in this area works for issuers as well as investors. Both groups should be in agreement from the start that standardisation would be of benefit. The ability of firms to tailor financing options to suit their business needs is important. Any action taken in this area should be market-led and we would advocate issuers and investors work together to identify any barriers that currently exist and develop solutions that satisfy the needs of both parties.

Another area where developing scale would be helpful is in the area of infrastructure investment. Making infrastructure investment a discrete asset class, with standardised reporting, documentation, etc., would help to attract a higher level of buy-side private investment.

Greater standardisation and comparability would also be helpful for corporates and retail consumers to enable them to shop around. For example, terms and conditions for small and medium sized enterprise (SME) loans vary greatly, which makes it difficult for SMEs to compare different funding propositions. Another area where greater standardisation would be helpful relates to corporate credit information.

Developing scale at institutional level

It has been widely commented that the European market is highly fragmented and that there are too many financial services operators for the size of the market, particularly when compared with the US. This fragments the pools of capital and liquidity and prevents efficiency gains.[1]

Consolidation in the sector would not only lead to efficiency gains but also increase integration of markets in Europe by creating truly European, rather than national, financial services actors. Competition policy will be important in this context to ensure that competition is viewed from a European, rather than national, level, as well as the existence of non-EU competitors.

- **GLOBAL CAPITAL AND THE NEED TO ENSURE THAT EUROPE REMAINS COMPETITIVE AND ATTRACTIVE FOR INVESTMENT**

While the primary aim of a Capital Markets Union is to re-balance the European economy towards greater market financing and to reduce the fragmentation of the Single Market in Europe, we would underline the need to consider the international dimension of the Capital Markets Union.

Financial markets are global in nature and therefore the EU does not operate in a vacuum. We need to be mindful of the impact of regulation on the competitiveness of an industry that not only competes in the EU but across the globe. Achieving scale, at a global level as well as European level, is a necessary part of being able to compete.

Every day, firms interact through the global capital markets in many different and sometimes complex ways. These activities are fundamental to funding and managing the wider economy. Therefore, international capital flows are a key enabler for growth globally and needs to be taken into account in regulation. Financial markets are global in nature and regulatory divergence, therefore, carries a variety of costs. It enables regulatory arbitrage that can undermine the effectiveness and stability of the global financial system and introduces duplicative or inefficient practices for both providers and users of capital. Therefore, effective cross-border regulation should be seen as a complement to preserving financial stability and maintaining high standards of investor protection and market integrity. Restoring trust between regulators is crucial to prevent disruption to cross-border capital flows and fragmentation of global markets. Extra-territoriality in regulation should be avoided.

Further integration in the EU should not be at the expense of links with non-EU countries. We need to ensure that Europe remains open to cross-border investment and can attract capital from outside the EU. The success of the Undertakings for Collective Investments in Transferable Securities (UCITS) brand shows that a competitive product that meets the demands of investors can attract global capital to the EU. Developing similar *pole d'excellence* in key products could replicate the success of the UCITS framework to attract capital to Europe.

The treatment of third country access in European regulation has been problematic in a number of dossiers. While the issue of cross-border regulation is not unique to Europe, but rather a global issue to be addressed in international fora, the strict equivalence regimes and attempts to introduce reciprocity in European regulation would have the effect of cutting Europe off from global capital markets and we must avoid becoming "Fortress Europe".

While there is no "one-size-fits-all" model for equivalence that will work across the board, we believe that a better equivalence regime should be based on the following criteria:

[1] See speech by Yves Mersch on the need to consolidate the banking sector in Europe: https://www.ecb.europa.eu/press/key/date/2015/html/sp150310.en.html

- Assessments should be outcomes-based and proportionate, focusing on the material risk posed to EU financial stability while avoiding market disruption;
- Equivalence should focus on the ability of European firms to access third country investment services and infrastructures;
- Assessments should include the possibility of partial equivalence decisions; and
- Clear transitional measures should be put in place in the intervening period. Including the power to implement 'no action' decisions to avoid market disruption.

In the longer term, the EU should take a leading role in international fora such as the Financial Stability Board (FSB) and the International Organisation of Securities Commissions (IOSCO) to improve the consistency of cross-border regulation.

Finally, ambitious trade deals that tackle regulatory barriers and facilitate regulatory cooperation, such as the EU-US Transatlantic Trade and Investment Partnership (TTIP), should be promoted.

Short-term priorities

The short-term priorities for the EU in this area are already well known:

- Reviving the **securitisation markets** in Europe for good quality products and ensuring appropriate calibration of capital requirements in both Capital Requirements Directive 4 (CRD4) and Solvency II.
- Developing a **European private placement regime**, building on successful national regimes.
- Reviewing the **Prospectus Directive** to lighten the burden on SMEs.
- Reviewing **the cumulative impact of financial services regulation**.

Securitisation

The new Basel II/CRD4 rules make a viable securitisation market essential in order to ensure adequate funding to the wider economy.

We welcome the ongoing work to develop standards to high quality securitisation but would stress that work should focus on what makes a good securitisation structure, rather than on the assets. In this regard, we fully support the work undertaken by the European Central Bank (ECB) and Bank of England (BoE).

We are cautious about the value of securitisation for SME loans. SME loans display a large degree of heterogeneity, which makes securitisation more complex. However, progress in revitalising the securitisation in credit cards and mortgages could have an indirect benefit for SMEs by freeing space on bank's balance sheets for SME loans.

Private placement regime

We fully support the work undertaken by the International Capital Markets Association in developing a pan-European private placement regime.

While a successful private placement regime is clearly a useful tool to be made available to issuers and investors, this should be seen as a stepping stone to listing on the public markets and the incentives need to be calibrated with this in mind.

Reviewing the Prospectus Directive

A thorough review of the Prospectus Directive is required in order to lighten the burden on SMEs seeking market financing and, in this respect, we welcome the Commission's public consultation.

It is crucial that significant efforts are made to make the listing process easier for those companies seeking expand using open market financing, while the establishment of a streamlined regime for liability and sanctions across all Member States is necessary to ensure that investor protection is not compromised.

Cumulative impact of regulation

A vast amount of new regulation was introduced following the financial crisis, with many actors and activities falling within the regulatory perimeter for the first time.

It is therefore important that a thorough ex-post impact assessment takes place to not only identify issues within each individual regulation but also the interplay between the different regulations to ensure that the right balance between stability and growth is achieved.

We would like to see a full cumulative impact assessment, rather than a piecemeal review, of each regulation as the review clauses are activated as this will be the only way to ensure that the full impact of the regulation can be evaluated through the prism of the Capital Markets Union. While we recognise that full ex-post cumulative impact assessment can only be completed once the new regulatory framework have been fully implemented in 2019, some areas of concern have already come to light during the implementation phase and should be addressed as a priority (see Annex).

Work should begin now to develop the methodology for such a review to ensure that it does not focus purely on costs, but more importantly on impacts and barriers to a Capital Markets Union. In terms of reviewing legislation, we need to consider all regulation against the following criteria:

- Does the cumulative regulation ensure the competitiveness of Europe?
- Does the cumulative regulation achieve an effective balance between financial stability, safe and efficient markets, and jobs and growth?
- Does the cumulative regulation ensure that Europe remains open to global capital markets?
- Is the cumulative regulation fully consistent with international standards and with legislation in other key jurisdictions to ensure cross-border capital flows are not interrupted?
- Are there inconsistencies or barriers created by various elements or regulation? Are the regulatory outcomes for the same activities or instruments the same across legislation?

Medium-term priorities

Building a Capital Markets Union will require more than tweaking of the regulatory regime but a fundamental change in culture to build the appropriate ecosystem for market-based finance to flourish.

Corporates

The European economy needs more risk capital. Academic evidence shows that businesses, where they have access to large pools of liquidity in the form of institutional investors tend to equitise their funding in order to take advantage of this fact.

Multinational and blue chip companies have ready access to the capital markets. Therefore the focus has rightly been on SMEs. However, the SME label is too broad and needs to be broken down into different segments in order to ensure a tailored policy response.

Access to the capital markets, both public and private, is likely to remain the preserve of middle market companies and high-growth SMEs. However, increasing the access of these companies will indirectly help smaller SMEs by freeing up banks' balance sheets for those SMEs which will remain reliant on bank finance.

The lack of standardised credit information for SMEs has been identified as a key issue. A number of Member States have set up Central Credit Registers (CCRs) in order to facilitate the sharing of credit data and this could be replicated in other Member States under a best practice regime. Indeed, we would like to see such information shared more readily cross-border, both with banks and non-bank sources of financing. Regarding the latter, the exchange of credit information would only take place where certain data protection safeguards are met and user-profiles defined.

However, SMEs also suffer from the lack of standardised information regarding funding. While mortgages and personal loans display a high degree of standardisation, which enables easy comparison, the same cannot be said for SME loans. Greater standardisation of loan terms for SMEs would ensure greater transparency for bank finance dependent SMEs.

Many of the regulatory initiatives in recent years, such as Markets in Financial Instruments Directive (MiFID), have focused on improving the efficiency of secondary trading, at the expense of reducing costs in the primary market. While low transaction costs have benefitted traders, the pass-through effect to issuers has been limited. While ensuring a liquid secondary market is essential for issuers and investors, one of the consequences is that most market-makers' business models are based on volume, and therefore the cost of making a market in SME and mid-cap stocks is limited due to the high costs and limited turnover. This could be addressed through preferential capital treatment for investment banks making markets in SME stocks or by calibrating carefully for less liquid securities in the transparency requirements of MiFID II.

Finally, a key barrier to further growth of European companies is their appetite to take risk. The ability to manage risk is fundamental to companies, including when raising capital. Access to liquid and efficient derivatives markets ensures that companies can manage their risks efficiently, can broaden the financing options for companies by allowing them to raise funds in other markets and therefore can lower the cost of raising capital. Maintaining the exemption in European Market Infrastructure Regulation (EMIR) and the Credit Valuation Adjustment (CVA) exemption in CRD4 for non-financial corporates is necessary to ensure that corporates are not priced out of the market for these instruments. Longer term, this issue needs to be re-examined by Basel to ensure a level playing field globally.

Investors

The majority of retail savers access the financial markets through collective schemes such as UCITS, pension funds and life insurance. Therefore, promoting the role of institutional investors will be key to increasing market-based financing and integration of European markets. Studies show that retail savers display a strong home bias and strong risk aversion, which makes long-term, cross-border investment challenging, but these can be overcome by channelling savings to institutional investors who can deploy the pooled funds for long-term investment. Through collective schemes, savers benefits from the diversification that such investment can offer while maintaining the ability of savers to redeem their investments when needed.

The success of the UCITS framework shows that it is possible to design a competitive product with high levels of consumer protection that can attract substantial capital both from within the EU and globally. Recent moves to create similar products such as the European Long Term Investment Funds (ELTIF) and European Venture Capital Funds (EuVECA) need to be promoted, as well as consideration of what other EU products could be developed, such as a pan-European pension product.

However, we also need to examine the legal impediments facing institutional investors that prevent them from allocating their capital in the most efficient way.

The top three which we have identified are:

- **RULES THAT LIMIT THE RANGE OF INSTRUMENTS INSTITUTIONAL IN WHICH INVESTORS CAN INVEST**

There continue to be restrictions on the types of instruments in which institutional investors can invest, for example through the Solvency II regime, which disincentivises insurers from holding long-term assets. Institutional investors are also incentivised to hold significant quantities of sovereign debt given the current bias in regulation towards sovereign bonds vis-à-vis corporate bonds. An asset passport could be helpful in tackling these issues.

- **RULES THAT PREVENT DIRECT LENDING BY INSTITUTIONAL INVESTORS**

In the UK, direct lending by institutional investors is possible without a banking licence. This has enabled new markets to develop, such as peer-to-peer lending. However, in many European countries originating a loan requires a banking license, which prevents institutional investors from undertaking this activity.

- **IMPROVING ACCESS TO INFORMATION ON SMES AND INFRASTRUCTURE PIPELINE**

Better access to SME credit information and a more transparent infrastructure pipeline would assist institutional investors with their due diligence and make them more willing to invest in these products.

Increasing the participation of retail investors directly in capital markets could also be explored. Further, financial intermediaries could do more to incentivise retail customers to consider alternative investment options such as shares and bonds *(see below)* while at the same time ensuring that high levels of investor protection are upheld.

Financial intermediaries

Building a Capital Markets Union will require re-thinking the role of financial intermediaries and business models.

- **REDUCING COSTS BY IMPROVING EFFICIENCY**

Regulatory reform for the past twenty years has aimed to improve the efficiency of trading across Europe, and many of the regulatory actions in the space are welcomed by the industry, in particular MiFID II. However, inefficiencies in the system remain and further work to standardise processes should be a priority, both for the industry and policymakers. For example, many of the Giovannini barriers relating to clearing and settlement have yet to be addressed. This is particularly true in the area of Central Securities Depositories (CSDs) where, apart from the two International CSDs (ICSDs), CSDs remain largely national in nature in the EU. Although industry efforts have led to significant links being built up between national CSDs, greater cross-border consolidation of CSDs in Europe would help to achieve economies of scale in the industry and reduce costs and risks for investors.

- **RE-THINKING DISTRIBUTION**

For many retail investors and SMEs, their local high street bank remains their one-stop-shop for financial services. Therefore, we need to re-think the role that banks play in acting as a hub for savers to access a wider spectrum of savings products and for companies to access a broader range of financing solutions in order to optimise the mobility of capital from one financial channel to another.

There is also anecdotal evidence that it is difficult for institutional investors to market their products cross-border due to the high cost of distribution. Access to advice for consumers is another limiting factor in incentivising consumers to invest their money outside the banking sector. Recent measures in legislation have tried to limit commissions and inducements but this often means that consumers are put off paying for advice. Legislation therefore needs to balance the benefits of providing advice to consumers with potential conflicts of interest.

Equally, banks can play a greater role in acting as intermediaries for institutional investors in order to move from an "originate to distribute" model to an "invest to lend" model. For example, a recent partnership initiative launched by Société Générale and AXA offered companies alternative co-financing solutions, targeting those with robust operational models and sustainable credit profiles.

Technological advances have enabled new ways to bring savers and companies together, with crowdfunding being a leading example. While it remains a niche area, in the future, similar "dating sites" could also be created for venture capital, business angels and private placements, as well as comparison site for consumers to compare savings products.

- **ACCESS TO GLOBAL MARKETS**

While reducing intra-EU fragmentation is important, reducing global fragmentation of capital markets will also be important. We, therefore, believe that the EU should play a leading role in international discussions to promote cross-border coordination of regulation and supervision. However, this should start at home with a wholesale review of the existing third country access rules and equivalence regime that has been put in place, which in many cases disrupts EU firms' access to global pools of capital and liquidity. The current negotiations on TTIP are welcome as a first step in creating greater coherence of cross-border regulation between the EU and US, but this should not be to the exclusion of similar work with other regions, in particular Asia and other high growth economies.

Longer term priorities

The Commission anticipates that the Capital Markets Union will be fully operational by 2019. In order to achieve this goal, there needs to be a significant change in the way in which investment is viewed by both institutional and retail investors in order to, firstly, increase the overall amount of capital within the financial system and, secondly, improve the efficient allocation of capital across the EU towards long-term investment.

Debt vs. equity bias

Europe needs more risk capital. There are many reasons why corporates rely on debt: greater understanding and access to bank loans, reticence by the entrepreneur to cede control of the company to shareholders, etc.

However, the unfavourable tax treatment of equity compared with debt in some Member States may also be a motivating factor. Member State level reviews looking at how to boost the use of equity finance and the role the tax system can play to achieve this could help promote equity financing across Europe.

Incentivising households to save for the long-term

While the overall amount of savings in the EU and the US is comparable, a major difference is the proportion of these savings held in banks versus investments. Research shows a positive correlation between the size of the institutional investor pool and the size of the capital markets, as they provide a pool of savings to be invested in risk capital.

Therefore, incentivising households and retail savers to save for the long-term through institutional investors is key. Creating the right products to meet savers' needs, as well as putting in place accessibility and the right incentives will be crucial. In particular, incentives need to target the strong liquidity preference and risk aversion displayed by retail investors. Tax incentives, in particular, play a key role in many national fiscal systems to incentivise savings for retirement, as well as in other areas such as venture capital, and better coordination of these could be included in the European Semester, as well as on a product-by-product basis.

Harmonising insolvency law and taxation

While differences in insolvency law and taxation undoubtedly impact on cross-border investment, harmonising these areas will be politically fraught and therefore will take many years to address. However, we do see merit in exploring the possibility of developing a 29th regime for insolvency law, enabling middle sized companies looking for cross-border investment to opt-in to a harmonised regime. The removal of withholding taxes could also be prioritised, as well as exploring areas of tax that could be harmonised on a product-by-product basis.

ANNEX

Level 1 measures currently under consideration that should be revised or withdrawn

1. Financial Transaction Tax

We do not believe that a Financial Transaction tax is compatible with the European Commission's stated aims of promoting jobs, growth and investment.

The FTT would conflict with the desired aim to diversify the funding sources for corporates so that their reliance on bank funding is reduced. At a time when bank funding is constrained, the main alternative avenue for funding is the financial markets. However, the use of the capital markets, which is already underdeveloped in the EU compared with some other economies, will be further disincentivised as these transactions will be subject to FTT, and therefore more expensive, whereas bank loans will not and will therefore be relatively cheaper.

2. Banking structure reform

There are compelling arguments for reviewing the proposal made by the previous Commission on the structural reform of banks as part of the Better Regulation initiative. As exemplified by the recent AQR and stress tests, banks are well capitalised and able to withstand significant shocks, however, the current reform proposals are likely to damage the ability of banks to provide liquidity to markets (over and above some of the measures noted below) and service customers, in particular SMEs, and thus undermine economic growth. With the new focus on the creation of a Capital Markets Union, it is right that this proposal be re-examined to ensure that it does not undermine efforts to promote market financing of the European economy.

Finally, there are measures that have been adopted already at national level, the implementation of which would be subject to substantial uncertainty and delay if the Commission proposals were adopted. These national measures appear to provide appropriate remedies therefore with respect the principle of subsidiarity EU measures might be judge unnecessary.

Level 2 measures that could be better defined and calibrated:

1. Leverage Ratio

There is evidence that banks are already shrinking Rates/Repo business and liquidity in those products may be challenged by smaller and less elastic balance sheets. Repo markets are crucial to short-term liquidity. It may also impact on Prime Brokerage activities. Ultimately, the leverage ratio impacts on incentives for client clearing which may increase end-user pricing or impact participation in certain markets.

We therefore need to avoid the **Leverage Ratio** becoming a primary constraint on market makers' balance sheet capacity instead of the back-stop measure that it was intended to be. A couple of clarifications designed to ensure that the leverage exposure is appropriately calculated for securities financing, in particular for repo and reverse repo, would:

(a) ensure that netting is recognised as always applicable for trades cleared with CCPs and for bilateral trades with the same counterparty settling across the same system (as the delegate act recitals helpfully indicate);

(b) clarify that operational risk is dealt with in the capital rules and therefore should not be included in the leverage exposure calculation.

2. Net Stable Funding Ratio (NSFR)

The NSFR impacts on dealer funding costs to make markets (equities and securities financing transactions) and to support new issuance, as well as impacting reverse repo, which are used to manage inventories. It, therefore, reduces market makers' balance sheet elasticity to absorb inventory given increased stable funding costs.

Without reverse repo, or with a costly reverse repo, market makers would have to locate bonds before they could provide quotes to investors willing to buy, significantly reducing liquidity. To avoid the NSFR making reverse repo uneconomic, we would recommend that the level of stable funding required for reverse repo using LCR HQLA assets such as government bonds be set at the level of the haircut applied in the LCR, consistent with the approach applied to long cash security positions. We would further recommend that a zero stable funding weighting be applied to reverse repo for surplus liquidity deployment, and short covering.

Furthermore, the NSFR may have a negative impact on the funding of European firms, either to export or for their short term needs:

a) We would suggest that the Commission considers the read-across between the LCR and the NSFR on international trade finance loans, which are usually short-term and self-liquidating. It would seem somewhat illogical to permit a 100% inflow rate for trade finance loans for LCR and then to require 50% stable funding (as proposed by the Basel Committee in BCBS 295). A better solution might be to treat such loans as analogous to unencumbered loans to financial institutions (which attract a 15% required stable funding requirement) and then decided if this requires some level of funding if less than 6 months to maturity.

b) The same is true for factoring, which for businesses is second to the use of bank overdrafts as a short-term funding solution, with the operating loan needs of businesses hitting a record high in 2013 owing to persistently lengthy payment deadlines. The NSFR will further penalise an activity already encumbered by the anxiety gripping VSEs and SMEs over their short-term funding and cash flows.

As regulators reconsider the prudential treatment of **sovereign exposures**, either by requiring risk weighting, introducing Loss-Given-Default (LGD) and/or Exposure-At-Default (EAD) floors**,** and withdrawing IRBA model approval or flooring at Foundation levels (as the UK PRA, for example, has recently proposed). Any such changes should be consistently and uniformly calibrated, not taken in isolation, given the critical interaction with liquidity and leverage requirements.

3. MiFID

We need careful calibration of the new **transparency requirements** for bond markets under MiFID, currently under consideration by ESMA, to avoid further increasing market makers' risk, given that unwinding large positions will be more visible and take longer with smaller inventories and reduced liquidity. From this perspective, we would suggest that any post-trade transparency requirement on non-equity instruments include a cap above which the information would be publicly disclosed in a timely manner as to whether the amount of the transaction was equal to or above the cap and which would exclude the Legal Entity Identifier (LEI) of the market maker executing the transaction.

4. Securitisation

If we are to revive the securitisation market, we need to look again at the prudential rules for exposures to securitised assets. The treatment of high quality securitisations in Solvency II and CRD4 should be re-calibrated to ensure that both banks and insurers can hold these instruments without being subject to punitive capital charges.

- **Solvency II** – Capital charges for institutional investors remain too high despite recent EU re-calibration for Level 1 High Quality Securitisations (HQS). This must be adjusted when the legislation is reviewed if the ABS investor base is to widen.

- **The second iteration of Basel proposals will result in a capital treatment that is improved but still too harsh**. Capital would be around 7.5 times higher than levels applied for un-securitised assets of the same quality.

5. EMIR (reporting)

It is right for improved supervisory oversight that derivatives (together with related collateral movements) be reported into a central database (i.e. trade repository) but this does not require both sides to the transaction to report. As long as one side reports – and is required by law to do so – then the risk positions will be captured. Consideration should therefore be given to moving to 'one-sided' reporting (as practiced in other jurisdictions), especially as many end-users already delegate reporting to dealer firms anyway. This would reduce the burden on end-users, for whom derivatives remain an important but increasingly expensive tool.