IRSG

INTERNATIONAL
REGULATORY
STRATEGY GROUP

FINANCE FOR JOBS AND GROWTH IN EUROPE

The International Regulatory Strategy Group

The International Regulatory Strategy Group (IRSG) is a practitioner-led body comprising leading UK-based figures from the financial and related professional services industry. It is one of the leading cross-sectoral groups in Europe for the financial and related professional services industry to discuss and act upon regulatory developments.

Within an overall goal of sustainable economic growth, it seeks to identify opportunities for engagement with governments, regulators and European and international institutions to promote an international framework that will facilitate open and competitive capital markets globally. Its role includes identifying strategic level issues where a cross-sectoral position can add value to existing industry views.

TheCityUK and the City of London Corporation co-sponsor the IRSG.

1.0 EXECUTIVE SUMMARY

Europe's recovery in the five years since the financial crisis has been weak. Unemployment, especially among the young is a major concern. Reforms have stabilised the financial system, now the EU faces the challenge of establishing an agenda for jobs and growth in the 2014 - 2019 mandate.

We all rely on a stable and functioning financial system; successful enterprises cannot grow without the support of the financial services industry. The challenge for the industry is to deliver the services which individuals, families, businesses and society need.

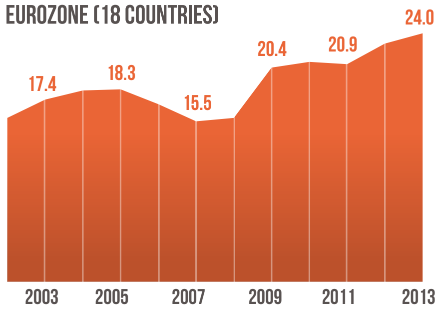
This report will show, through a series of case studies, that behind seemingly simple transactions, a complex financial infrastructure exists that helps people borrow money, receive their pensions and manage their investments. The value of different services provided to businesses, including supply chain finance, risk management and private placements that allow firms to secure investment is explained.

New and disruptive technologies are transforming the ways in which people access financial services. Direct payments and fund transfers by digital devices are rapidly emerging across the globe, often bypassing the development of traditional banking.

Europe is not alone in needing to address the challenge of an ageing population but has less time to do so than emerging economies. The EU's 2020 strategy recognises the challenges in the post-crisis landscape and sets out a ten-year strategy to build a competitive European economy fit for the 21st century.

YOUTH UNEMPLOYMENT

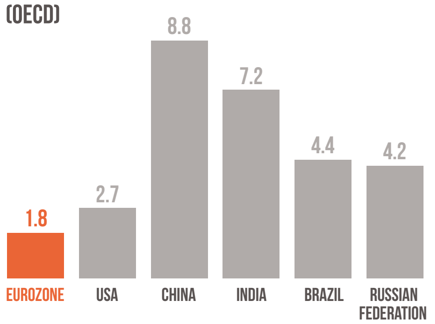
EUROZONE (18 COUNTRIES)



Nearly one quarter of Europe's young people are not in employment, education or training.

GDP GROWTH

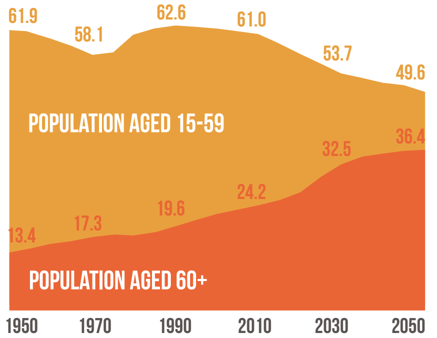
REAL GDP GROWTH IN % 2012-2017 (OECD)



The Eurozone's GDP growth over 2012 – 2017 is projected to be only two-thirds that of the United States and well behind the BRIC countries.

AGEING POPULATION

EUROZONE, %



Between 1950 and 2050, population aged between 15-59 as a share of the total will fall by 12% while the proportion of over 60s share will rise by nearly twice that rate.

An agenda for jobs and growth

European policymakers can help drive jobs and growth by:

- Adopting a strategy for jobs and growth over the 2014 - 2019 mandate
- Assessing the impact of policies on the jobs and growth agenda
- Consulting on draft legislation and attaching greater priority to growth when preparing legislation, including during the pre-legislative impact assessment phase
- Completing the Single Market in financial services
- Ensuring that investors are not barred from accessing global opportunities
- Promoting global co-ordination of regulation
- Enabling business to access the finance it needs – both from conventional and a range of alternative sources

The publication of this report is part of an ongoing dialogue about how the financial services industry can work best for Europe's people and businesses and more evidence and engagement will follow.

Poorly designed legislation can severely impede the financial services industry's ability to help European businesses to recover and grow. Policymakers can foster a regulatory climate that harnesses the full potential of the finance sector in supporting economic growth. Getting the balance right should be the priority for the 2014 - 2019 mandate.

Fundamentals for growth	Role of the financial services industry
Competitive businesses	• Providing both mainstream and alternative financing options to all sizes of enterprises
A stable business environment	• Providing a wide range of services that create more stable and predictable operating conditions for businesses
World class physical and technological infrastructure	• Providing the capital, expertise and investment to make long-term investments possible • Providing new digital technologies through which people access financial services
Channelling passive savings into active investments	• Providing a deep pool of capital to meet Europe's business and investment needs and safeguarding the retirement incomes of future generations

2.0 INTRODUCTION – A FINANCIAL SYSTEM THAT SUPPORTS JOBS AND GROWTH

The European economy faced many challenges during the 2009-2014 European legislative term as the global financial crisis exposed weaknesses in both markets and governments, culminating in the longest recession in the post-war era.

In response to the crisis and the challenging economic environment, significant progress has been made in strengthening regulation of the financial sector and building a new financial architecture. This has resulted in extensive regulatory and legislative reform across the financial services industry. The next phase of the response to the crisis should be to assess the impact of these changes and allow time for the reforms to take effect. Emphasis on creating the conditions to encourage growth must now take priority. In addition, the unemployment rate in EU28 is 10.7% (December 2013) and remains a concern for policymakers.

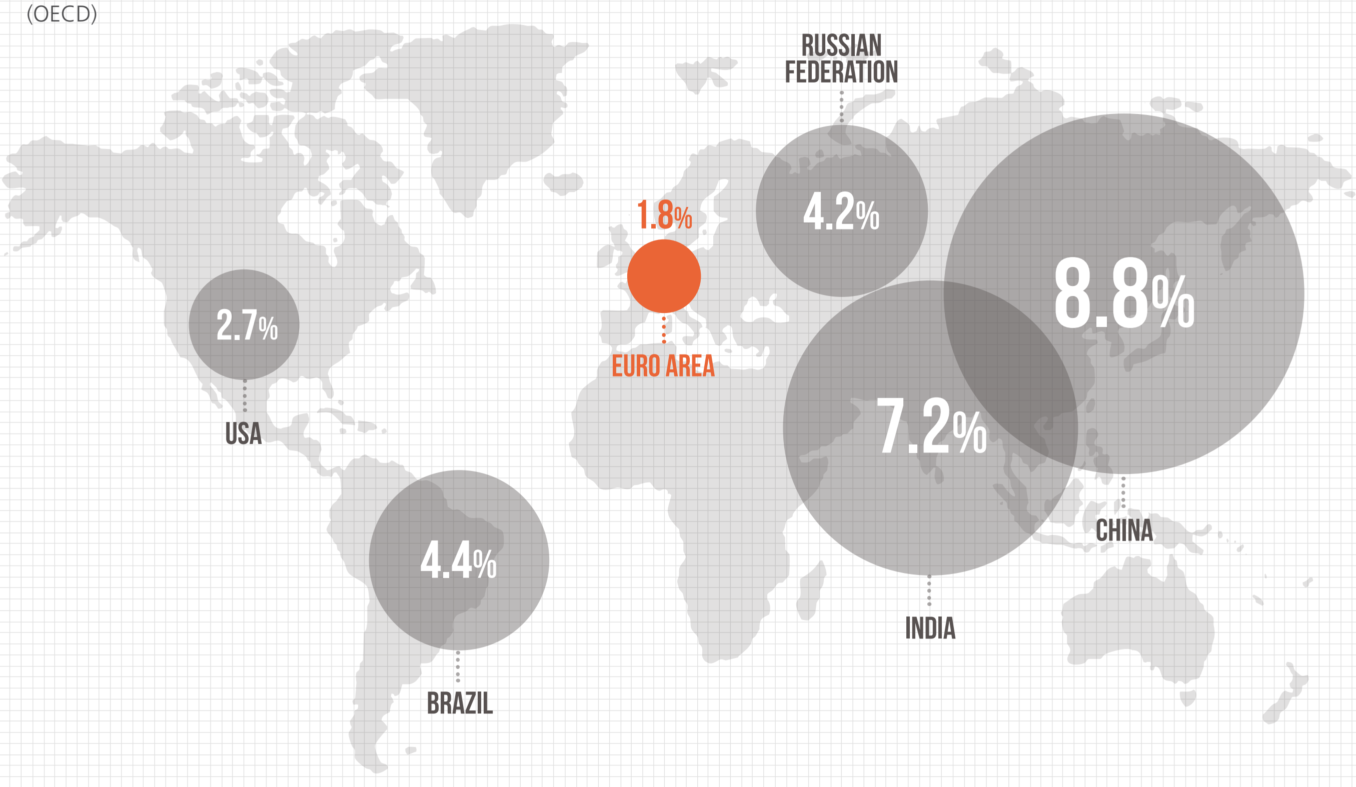
The economic challenges facing Europe over the course of the 2014 - 2019 legislative term should be seen in the broader macro-economic context of an increasingly competitive global economy. Between 2002 and 2012, China grew at an average of 10% a year and India at an average of 7%. By contrast, growth in the EU never rose above 3.4% in this period and fell to -4.5% in 2009. This was an exceptional time in both the EU and emerging markets but the wider trend is clear.

Promoting growth and tackling unemployment should be the primary objectives of the EU during the 2014 - 2019 mandate. Significant progress has been made since the crisis in strengthening regulation of the financial sector. A stable financial system alone is not sufficient to deliver jobs and growth. This will come from businesses that have the confidence to invest and hire more staff. Creating a regulatory climate that encourages growth must now take priority.

The imperative for policymakers is not just to promote growth but also to secure Europe's position in the global economy. This means confronting difficult issues: Europe is not alone in needing to address its ageing population for example, but has less time to do so than emerging economies. The EU's 2020 strategy recognises these challenges in the post-crisis landscape and sets out a ten-year strategy to build a competitive European economy fit for the 21st century.

EUROPE IN A GLOBAL CONTEXT

Real GDP Growth in %, 2012-2017 (OECD)



3.0 FINANCIAL SERVICES IN THE BROADER ECONOMY

The financial services industry provides a diverse range of support to businesses and individuals. This section provides an overview of these functions, from the provision of finance to businesses, to safely investing savings in Europe's infrastructure. This continuous interaction between Europe's businesses and the financial system is fundamental to Europe's growth prospects.

3.1 Creating a stable business environment

Europe's businesses have multiple and complex needs. These range from the need for finance in order to invest and grow a business, to the need to manage risks associated with currency or interest rate fluctuations, or the need to be able to pay employees or suppliers on time. These diverse services are provided to Europe's businesses by the financial services industry.

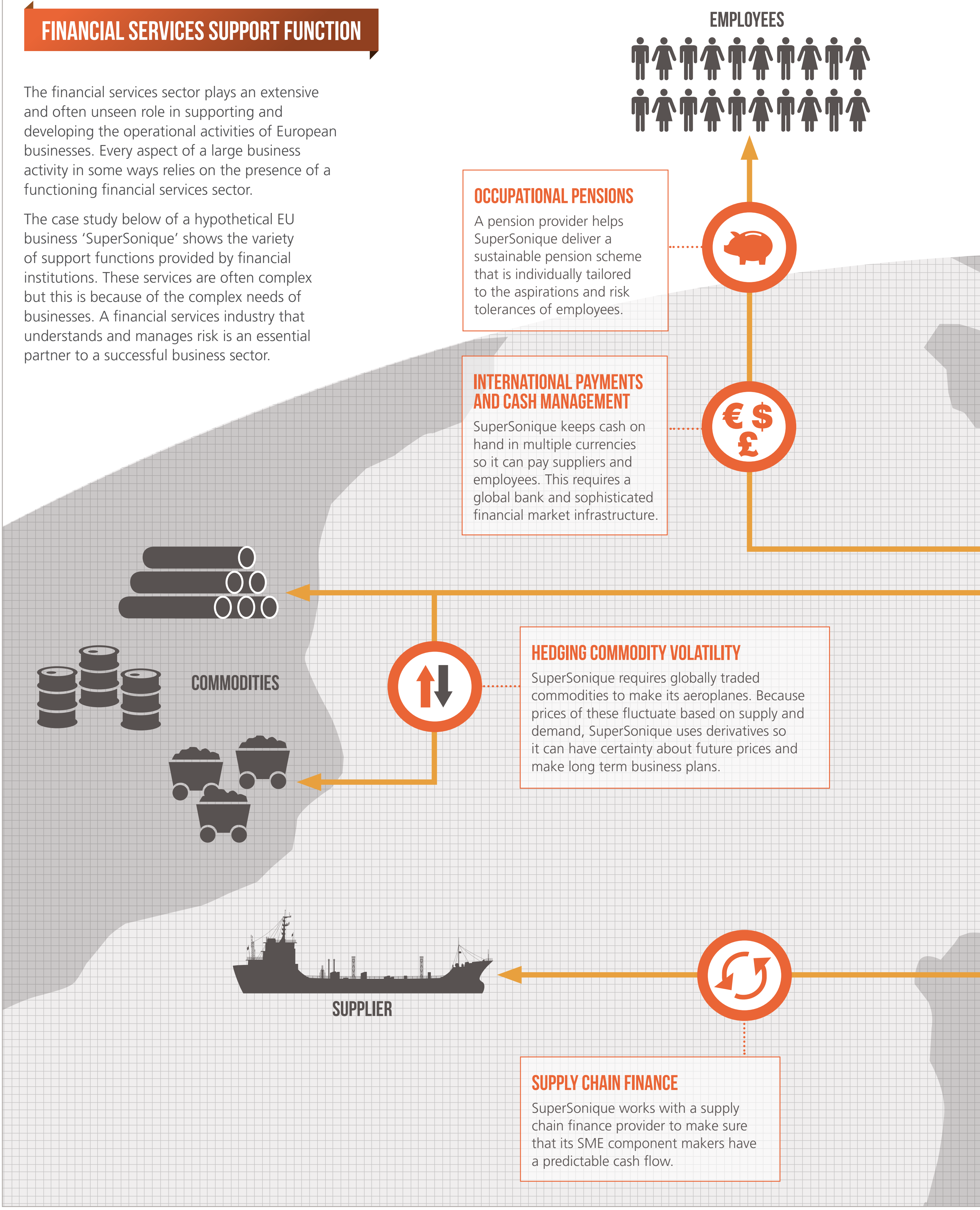
Intermediaries provide financial products that are essential to the risk management process. A firm operating in international markets will need to manage the currency risk of large transactions, or a firm reliant on a commodity will need to work with a bank to manage the risk associated with the fluctuations in the price of that commodity. Simple derivative products allow them to do so. Businesses also rely continuously on the financial infrastructure, including the payments system and services such as supply chain finance that take the risk out of making payments to suppliers. Creating a system that businesses can rely on requires huge and on-going investment by financial institutions.

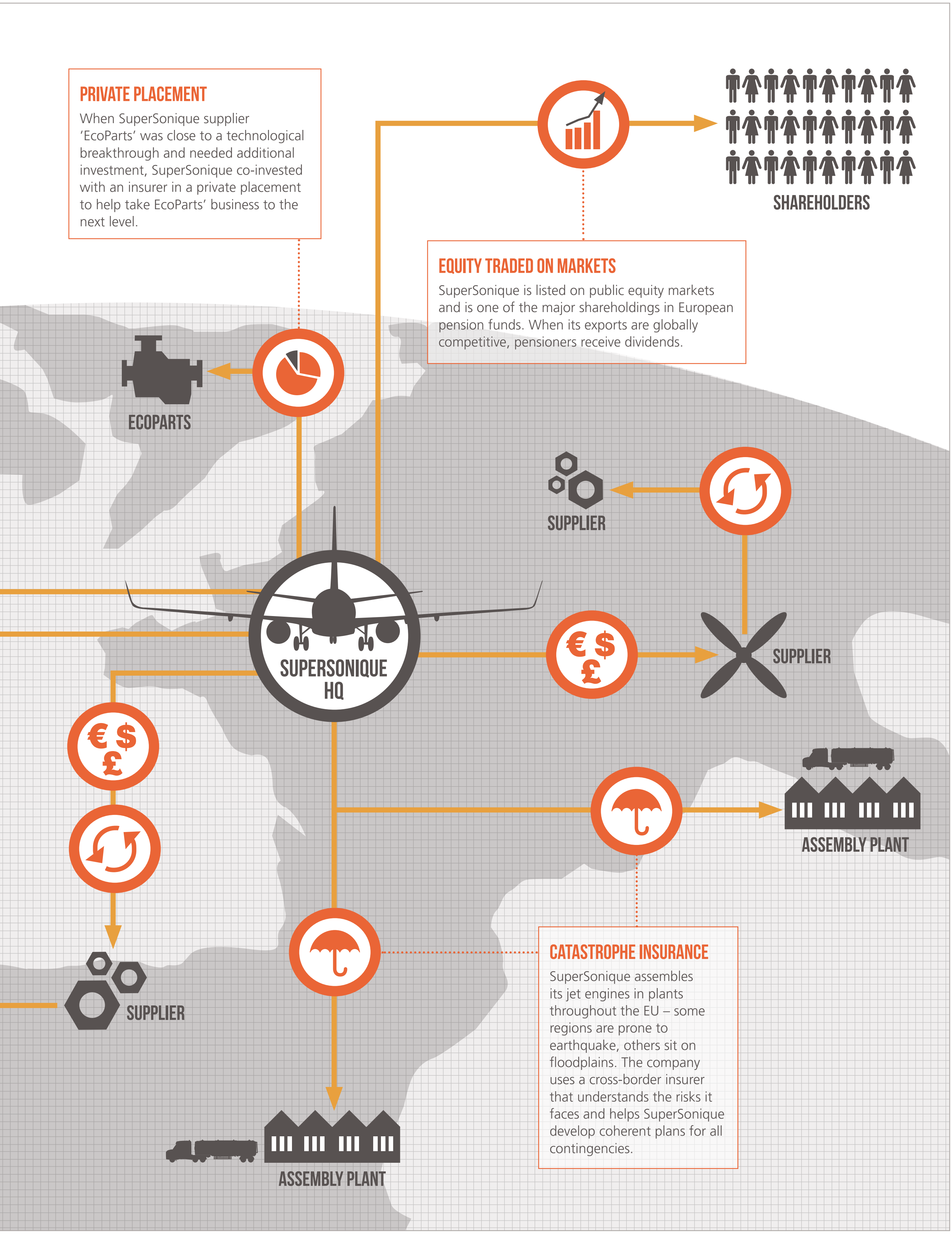
These services are not always visible but Europe's financial system provides support to businesses which helps to attract inward investment, manage everyday risk and interact in a modern payments infrastructure.

FINANCIAL SERVICES SUPPORT FUNCTION

The financial services sector plays an extensive and often unseen role in supporting and developing the operational activities of European businesses. Every aspect of a large business activity in some ways relies on the presence of a functioning financial services sector.

The case study below of a hypothetical EU business 'SuperSonique' shows the variety of support functions provided by financial institutions. These services are often complex but this is because of the complex needs of businesses. A financial services industry that understands and manages risk is an essential partner to a successful business sector.



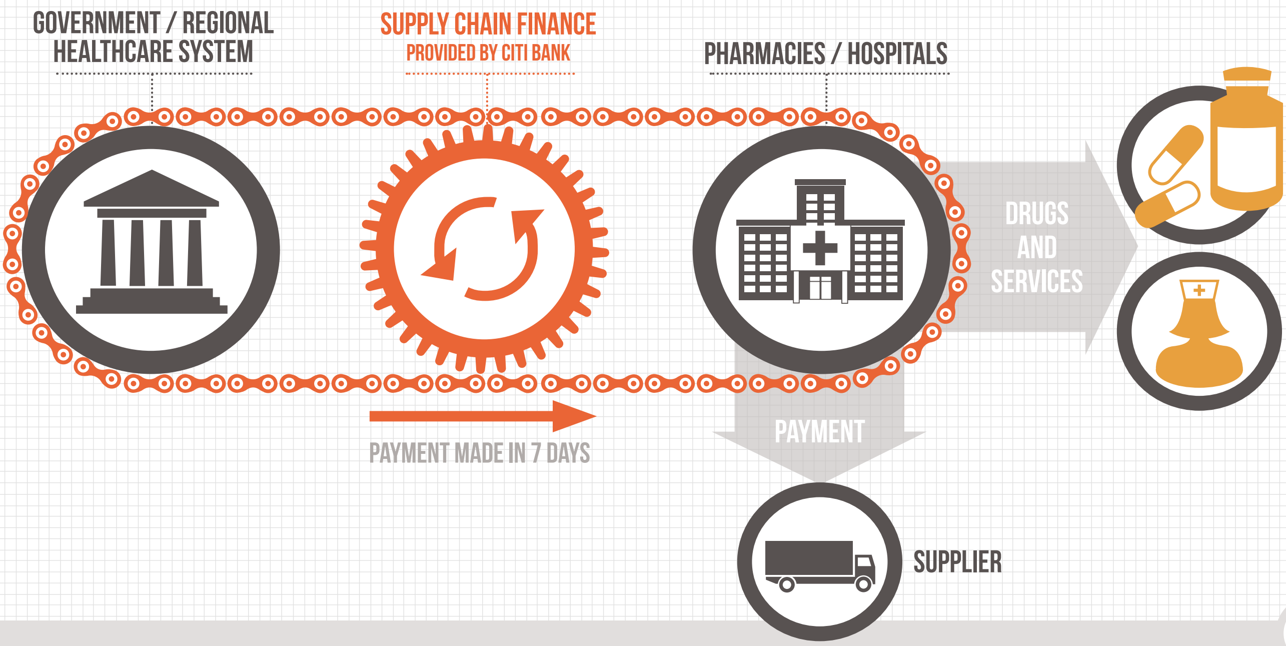

PRIVATE PLACEMENT
When SuperSonique supplier 'EcoParts' was close to a technological breakthrough and needed additional investment, SuperSonique co-invested with an insurer in a private placement to help take EcoParts' business to the next level.
SHAREHOLDERS
EQUITY TRADED ON MARKETS
SuperSonique is listed on public equity markets and is one of the major shareholdings in European pension funds. When its exports are globally competitive, pensioners receive dividends.
ECOPARTS
SUPPLIER
€ $ £
SUPERSONIQUE HQ
SUPPLIER
€ $ £
ASSEMBLY PLANT
SUPPLIER
CATASTROPHE INSURANCE
SuperSonique assembles its jet engines in plants throughout the EU – some regions are prone to earthquake, others sit on floodplains. The company uses a cross-border insurer that understands the risks it faces and helps SuperSonique develop coherent plans for all contingencies.
ASSEMBLY PLANT

FINANCING SMEs IN HEALTHCARE

Supply chain finance providers can increase SMEs' liquidity by advancing their cash payments based on the buyer's credit rating. This means that the SME suppliers to governments and corporates can access finance on more favourable terms before the maturity date of the receivable. Although a varied service, the most common function is for a financial institution to purchase a supplier's invoice in advance of its maturity date for payment, with the buyer paying the full invoice amount to the financial institution on the maturity date. The supplier receives prompt payment from the bank and the buyer continues to pay the invoice when it is due. Receipt of payments in advance of their due date can ease a company's liquidity, free up cash flow and improve the working capital position.

In the UK and Spain, Citi has provided supply chain finance to pharmacies to ensure that they receive payments prior to their maturity date. The first supply chain finance project undertaken by the UK Government is a scheme for community pharmacies in England, which could provide up to £800 million of new credit for around 4,500 businesses, many of which are SMEs. Citi was mandated to provide these services for the Government.

In Catalunya, Citi worked with the regional healthcare authorities that are responsible for running ten public hospitals serving 7.5 million people to establish a non-recourse buyer's credit programme. The programme ensures that hospitals receive timely payment for their services.



What is supply chain finance?

Supply chain finance plays an important role in managing the cash flows for businesses by introducing an intermediary between a buyer and supplier. This can provide certainty for businesses and can free up cash for investment. There is often a considerable delay between the provision of a service and being paid by the supplier. Supply chain finance can take many forms but the most common is for a bank to place itself between a buyer and supplier, by purchasing an invoice from a supplier at a discounted price. This means that the supplier will be paid in a shorter period of time by the bank, while the buyer can pay the bank at a later date. This has the effect of creating flexibility for the buyer and certainty for the supplier.

Providing greater certainty in the transaction chain is a simple concept but one that is important for businesses which rely on certainty in the cash management process and may be deterred from a transaction if they cannot be sure of the terms of payment. This can be especially important for firms operating in global markets which may have less visibility of their buyers. Financial services institutions can reduce the risk in international transactions by using their global footprint to provide a link between buyer and seller. The ability to construct sophisticated payment systems can also help manage large and complex products where one single buyer is purchasing goods and services from multiple buyers.

This often unseen service is important for the functioning of the European economy.

3.2 Financing world class infrastructure

Europe's future growth strategy depends on investment in high quality infrastructure. Infrastructure development brings immediate economic benefits in the initial construction phase and lasting economic and social benefits once projects are completed. The European Commission has estimated that Europe's investment needs in transport, energy and ICT networks to meet the Europe 2020 strategy are between €1.5 trillion and €2 trillion. In addition, a 2013 report by McKinsey estimated that as much as US$57 trillion in infrastructure investment will be required globally over the next 18 years to sustain economic growth. Meeting this target requires the existence of a financial services industry able to channel savings into infrastructure projects and an investment climate that encourages long-term investment decisions. This requires ongoing cooperation between the financial services industry, public sector partners and policymakers in order to design and promote new funding models and explore how to provide investors with the confidence to commit substantial funds to a project over a long period of time.

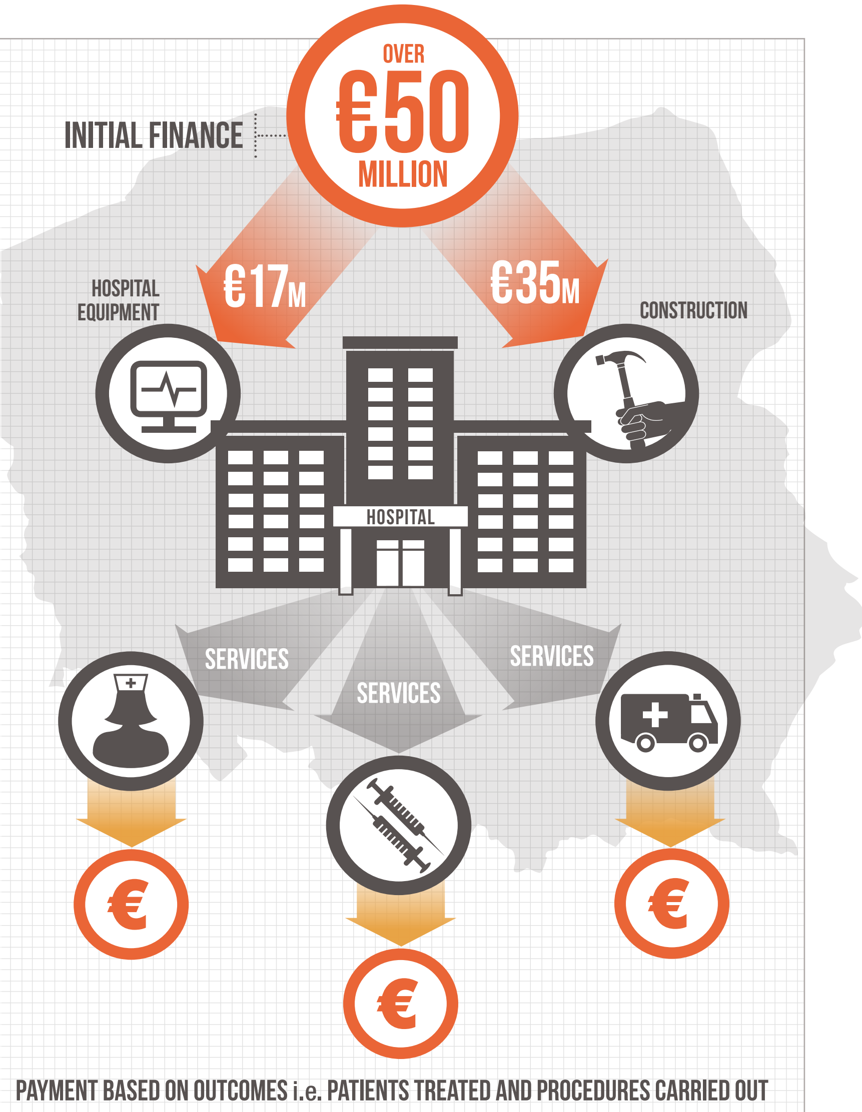
Public bodies and EU institutions have an important role to play in supporting European infrastructure projects. Public funds and support can help to manage early stage risks and improve the credit ratings of long-term projects, which facilitate the provision of investment from the private sector. The value to policymakers generated from increased cooperation with the financial industry is not just the provision of capital. Such investments in public infrastructure can raise the long-term growth potential of the European economy.

INFRASTRUCTURE FINANCING

Hospitals in Poland need to be upgraded in order for them to comply with EU technical and sanitary requirements. The required investment is estimated to be in the region of €1.5 billion. Poland's healthcare system has suffered in the past from underfunding and health spending remains lower than other Central European countries. The challenges facing the state are likely to increase in line with demographic pressures.

To fund upgrades in the healthcare system, the government needed to consider alternative financing arrangements. Public Private Partnerships (PPP) offer a means of attracting investors, while guaranteeing the quality of outputs. One example is Żywiec hospital where a PPP model worth over €50 million is being used to develop and run the hospital. The contract with InterHealth Canada Limited will last for thirty years and will create a usable area of approximately 18,000m² and 390 beds. In addition to construction, InterHealth Canada Limited will be responsible for not only the delivery of services but also the day to day maintenance and management of the hospital and the provision of healthcare services. Remuneration is dependent on the provision of health care services and based on measurable healthcare outcomes.

PPP can ensure that essential services are provided on terms that attract investors and meet the high standards required by the government.



What are public private partnerships?

Public private partnerships (PPP) provide a means of sharing the risk associated with a capital project between public and private partners. PPPs are increasingly being used to fund long term infrastructure projects where the initial risk in the construction phase of a project can act as a deterrent to private sector investment. The risk profile of long term infrastructure projects has meant that governments have traditionally been the main providers of finance. Growing infrastructure demands and pressures on government spending have created the need for innovative ways of sharing the risk between the public and private sector to be developed.

The financial services sector supports and facilitates PPP projects in numerous ways. Financial advisers advise on the likely sources of funding for a given project but the financing generally consists principally of senior debt and equity. The debt may be provided by commercial banks, international financial institutions or directly from the capital markets. In the last instance, the PPP company issues bonds that are taken up by financial institutions, such as pension funds or insurance companies which require long-term investments. Hedging instruments (such as interest rate swaps) are usually incorporated into the financing structure so that the PPP company has certainty as to the interest rate repayments. In addition, many PPP projects include financing facilities that provide temporary liquidity to deal with specific risks (for example a large depreciation of the local currency) and insurance against certain project related risks (such as construction risks, loss of revenue, third party liability and environmental liability).

SPECIALISED FUNDS IN RENEWABLE ENERGY MARKETS

Investment in renewables

Clean and renewable energy is a high value and growing global market, and a major growth sector for the European economy. Europe is committed to ensuring that 20% of its gross energy consumption comes from renewable energy by 2020.

Building the required infrastructure to meet this commitment requires complex and long-term investment. The active participation of government and the private sector is necessary. Governments and European institutions have an important role to play in managing the risk of long-term and complex investments. Governments can provide political and economic stability for potential investors by ensuring that the terms of long-term contracts are kept stable or returns from initial investments remain constant. The European Investment Bank can also play an important role, as shown below, by reducing the risk profile of infrastructure projects and thus attracting institutional investors.

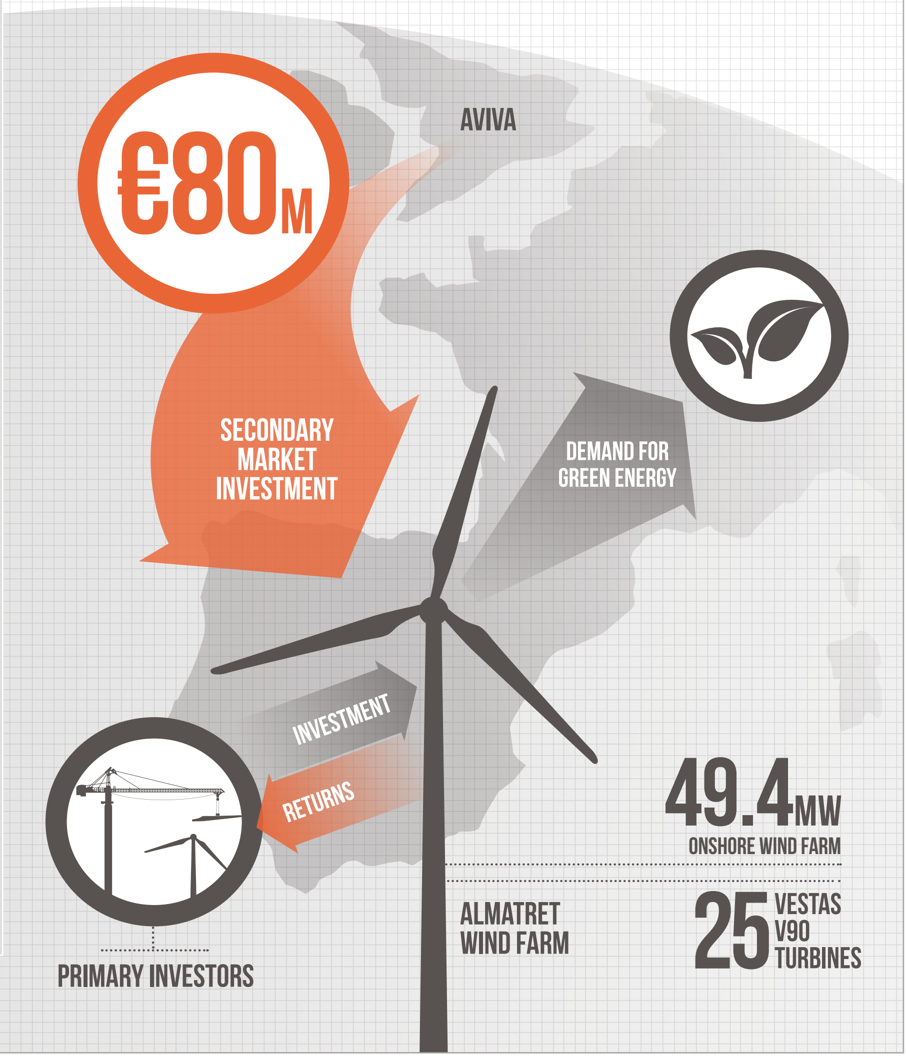
The presence of institutional investors both in the initial construction phase and in the secondary market, as shown here in the case of Aviva, supports the sector by providing not only initial investment but also the confidence that there is a growing group of willing buyers for large infrastructure assets at a future date.

As the following case studies show, governments rely on the active participation of the financial industry to meet their clean energy objectives.

Specialised funds are entering the renewable energy market, seeing renewable energy sites as safe assets. Recent investments in the secondary market by Aviva show that investment portfolios value the security that can be provided through renewable energy infrastructure. These assets allow Aviva to diversify its investment portfolio but are also a positive development for future investment in renewable energy markets. The entry of fund managers into the market represents a larger pool of capital available to the renewable energy sector.

A further benefit is that the presence of a secondary market sends a signal to prospective primary investors that there will be a market in the future to trade their assets, which reduces some of the initial risk of that investment.

This example shows how Europe's renewable energy commitments, the strength of the European renewable energy sector and the future incomes of European investors are closely interlinked.

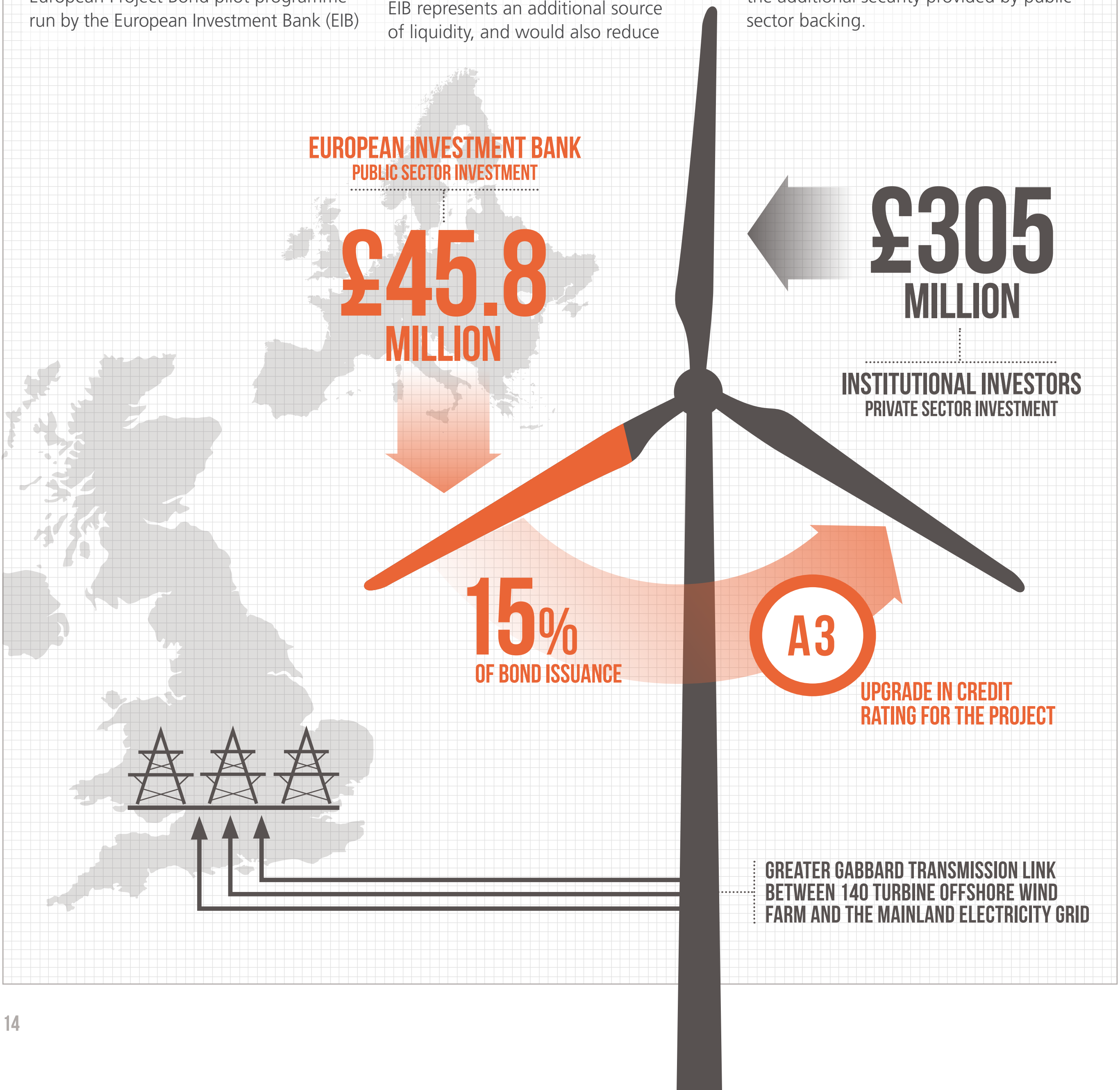


INVESTMENT IN WIND TURBINES

Greater Gabbard consists of 140 wind turbines off the coast of the UK. The UK Government is aiming for 15% of the UK's energy needs to come from renewable energy by 2020. In order for the Government to be able to deploy the renewable energy generated at the wind farm, significant investment is needed to connect the site to the UK energy grid.

BlackRock and other institutional investors have taken a significant stake in a European Project Bond pilot programme run by the European Investment Bank (EIB) to support investment in European infrastructure projects. The programme raised £305 million to finance the Greater Gabbard transmission link between a 140 turbine offshore wind farm and the UK mainland electricity grid. The £45.8 million guarantee by the EIB represented 15% of the bond issuance, and resulted in a one notch upgrade in the credit rating for the project to make it legally accessible for institutional investors. The credit enhancement facility provided by the EIB represents an additional source of liquidity, and would also reduce outstanding debt if required and act as a first loss debt piece in the financing structure.

The participation of the EIB has made possible substantial private sector investment in a project that is essential to the transmission of renewable energy to the UK grid and makes a contribution to EU renewable energy targets. Such levels of investment from private sector sources may have been difficult to attract without the additional security provided by public sector backing.



3.3 Channelling Europe's savings into investments

European policymakers face a significant challenge in ensuring that people have adequate pension savings to fund longer retirements. According to a study carried out by Aviva, the annual pensions gap is €1.9 trillion, which equates to around 19% of 2010 GDP across the European Union. The pensions industry helps to meet this challenge by providing incomes for retirement and channelling passive savings into active investments.

A pension fund serves as an aggregation of employee savings that can achieve better returns through economies of scale and the expertise of the fund manager. Pension funds tend to be constructed from a wide range of assets, ranging from low risk government debt, to equities or assets in emerging markets that are higher risk but offer the opportunity of higher returns. Due to the need to match long-term assets and liabilities, pension funds are well suited to help policymakers meet Europe's long-term financing objectives.

For pension funds to continue to deliver on this policy objective, regulators need to ensure that regulatory requirements do not inhibit the ability to hold assets over the long term. Equally important is that pension funds are able to access investment opportunities across the world and particularly in the fastest growing markets that can deliver the best returns to savers.

GLOBAL INVESTMENTS

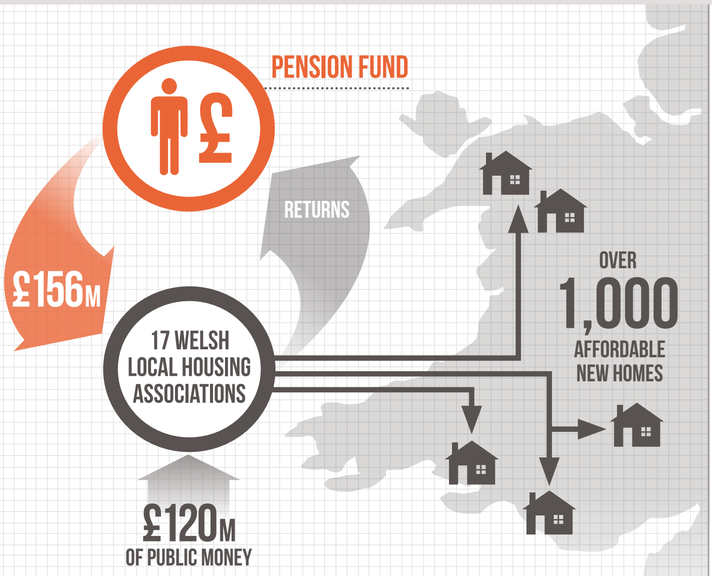
An individual's retirement income may be derived from a variety of sources including: a tax-advantaged savings vehicle containing cash and securities; an occupational and state pension; and an insurance policy or annuity. The income and capital appreciation generated by these vehicles will derive from a wide array of investments such as stocks, corporate and government debt, infrastructure, and other asset classes.

The primary benefit of ensuring investors can access a diverse pool of assets is to secure higher returns, adjusted for risk. A secondary benefit relates to the value of channelling savings into investment opportunities. As shown below, these can have broader social impacts by providing funding to important services or deepening the pool of capital in emerging markets.

INVESTMENT IN SOCIAL HOUSING

Pension funds need to invest in diversified assets including bonds, equities and infrastructure in order to guarantee stable returns. In the past few years institutional investors have increasingly seized opportunities in the social housing sector. In 2013, Prudential plc worked with the Welsh Government to provide £156 million of investment in the social housing sector in Wales. This will contribute directly to the building of over 1,000 new affordable homes across the nation.

The innovative deal was devised by Prudential's European asset management arm, M&G Investments, to provide long-term finance to 17 Welsh local housing associations. As part of the agreement, an additional £120m of public money will also be available in the form of new grants.

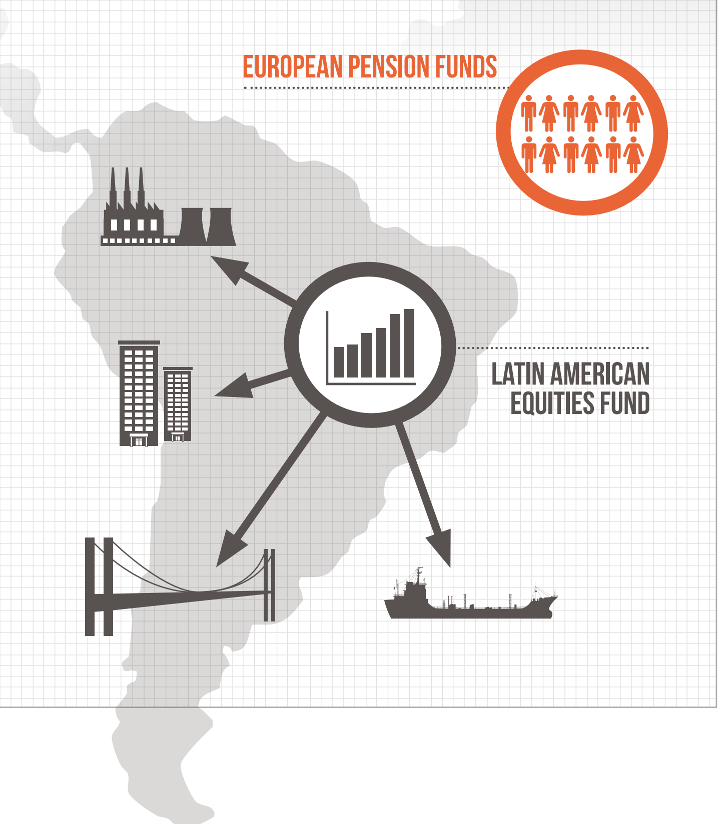


INVESTMENT IN HIGH GROWTH MARKETS

Investment opportunities offering the greatest returns will often be found in markets outside the EU. For pension funds to continue to deliver the best returns for investors, access to high growth markets across the world is especially important. Santander Asset Management's Latin American Equities offers the opportunity for individual and institutional investors to invest in high growth countries with strong domestic demand.

Beyond providing access to high growth markets, channelling European investments into Latin American equities serves a broader purpose of deepening the pool of capital available to domestic businesses and projects. In some of the markets, businesses or infrastructure projects may struggle to raise funds domestically. Access to global investment markets can increase growth prospects for businesses or the development of important domestic infrastructure.

Maintaining access between the EU and global markets is important, both for maximising investment opportunities for European investors and the broader growth and development prospects in recipient markets.

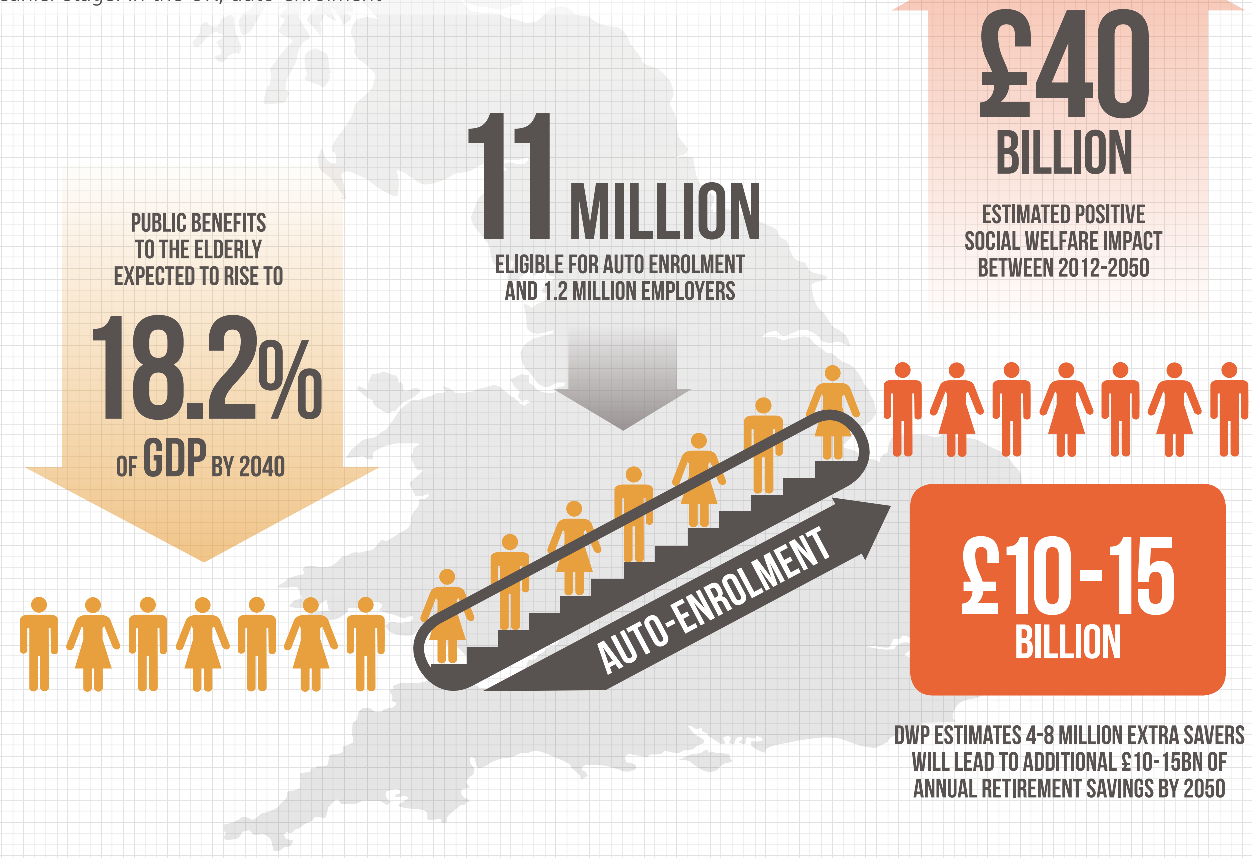


AUTO-ENROLMENT

A valuable function of a pension fund is to provide an income in retirement and help policymakers to address the challenge of an ageing population. But policymakers are struggling to ensure people save sufficiently for retirement. The costs of inadequate pensions will ultimately fall on governments particularly through higher health care costs.

Some Member States have moved ahead with bold reforms to compel saving at an earlier stage. In the UK, auto-enrolment – which automatically opts employees into pension schemes – began in 2012 and although at an early stage, has the potential to be a major step towards addressing under-saving in pensions.

This shows the value of financial services products and pensions in helping policymakers to meet one of the challenges to long-term economic growth.



3.4 Market finance: helping EU businesses to remain competitive

Europe's businesses need a diverse range of funding sources to invest, grow and compete in global markets. Well-functioning capital markets and access to capital are prerequisites for future growth.

Bond financing is another way in which companies can raise debt finance without seeking bank borrowing. Business finance takes many forms, incorporating direct finance and bank lending. Alternative finance is becoming more prevalent and other types of financial institutions and related activities are arising to intermediate between business and savers. While bank finance is expected to remain an important source of finance to businesses, it is important that Europe seeks to develop a 'second cylinder' of finance that will help the economy throughout the credit cycle. This second cylinder includes private placement, securitisation and other forms of non-bank finance. The provision of, and access to, a deep pool of capital across the EU ensures the efficient functioning of the Single Market.

What is private placement?

A private placement (PP) occurs when an institutional investor lends money directly to a company in a 'private' transaction. PPs are typically for longer term money, say 7 years, and at a fixed rate of interest. However, the smallest loan sizes are typically around the €10m mark, which means the PP market is, at least currently, best suited for middle markets and larger companies.

The USA and Germany have large and well-developed PP markets (€41bn and €14bn respectively in 2012), while France's PP market has been developing quickly from a small base over the past year or two. The PP markets in the USA and Germany have also shown dramatic growth, doubling in size in the past few years.

What is securitisation?

Securitisation is a technique by which SME and mid-market company debt is passed from banks to, typically, non-bank actors such as insurance companies, pension funds and asset managers. This increases credit supply to the real economy and represents a diversification of funding sources to SMEs and mid-market companies.

SMEs and mid-market companies benefit from securitisation because it supplements bank lending capacity with very large non-bank pools of capital. This form of funding should in principle help to relieve constraints on bank lending capacity to the real economy, diversify funding sources for SMEs and mid-market companies, enhance financial stability, and help banks to strengthen their balance sheets.

Securitisation can take many forms, some of which were associated with risky practices prior to the financial crisis. However, there is growing interest in the potential of transparent and simple securitisation products to increase funding opportunities for SMEs and mid-market companies. Leading central bankers including Mario Draghi and Mark Carney have acknowledged its potential, as has Commissioner Michel Barnier. The recent proposal for structural reform of European banks included a specific reference to securitisation to ensure that it was not unfavourably treated by new regulation.

RETAIL EXPANSION

Founded in 1924, Hugo Boss is one of the biggest names in the world of fashion with a rich and diversified portfolio of products, which includes clothing, accessories and footwear for men and women. It enjoys excellent brand awareness, strong product recognition and a consolidated global presence.

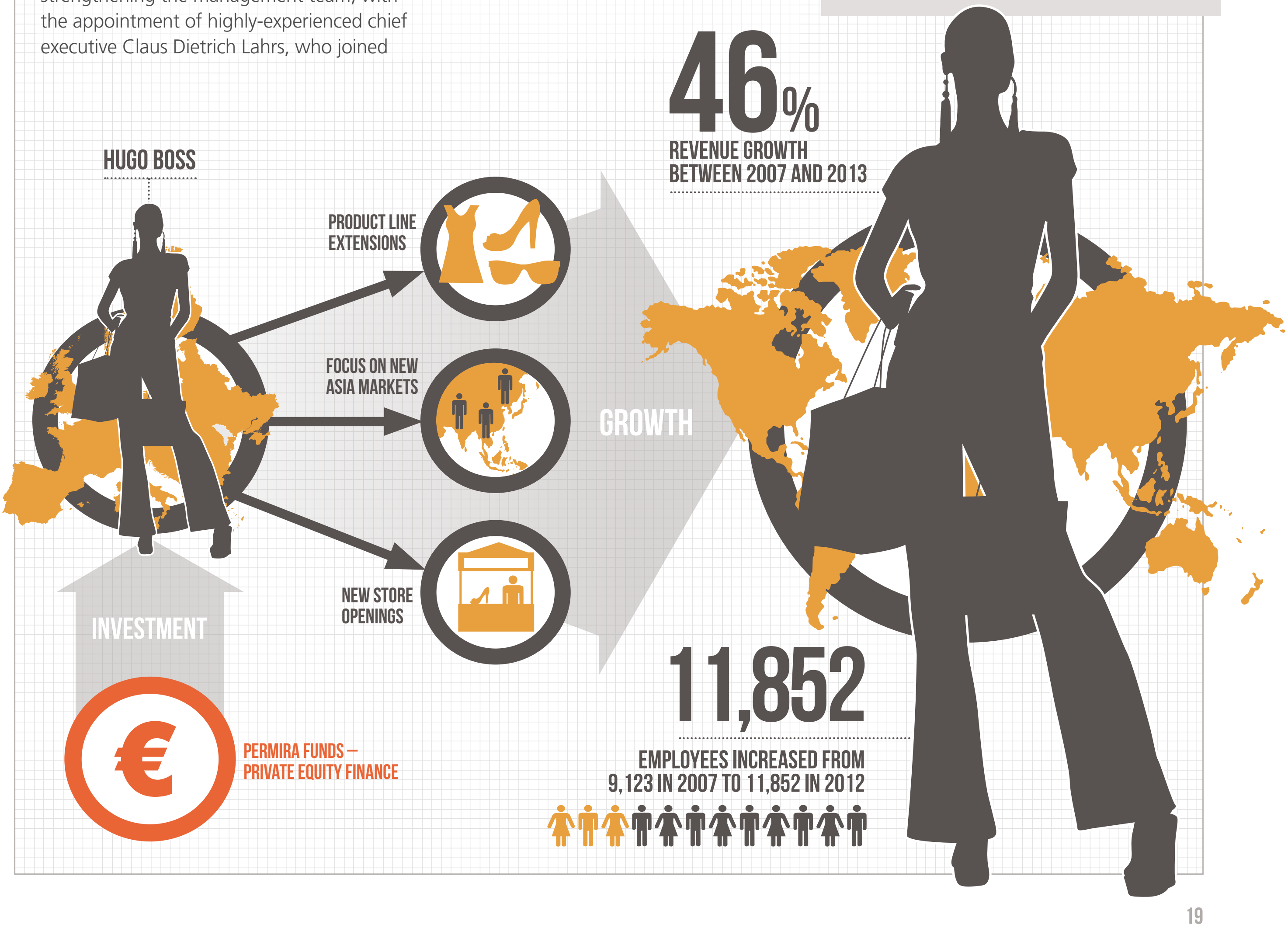
In 2007, a company backed by Permira funds acquired the Italian business Valentino Fashion Group, through which it acquired a controlling stake in the larger listed German company Hugo Boss. The investment strategy for Hugo Boss was to help the business transform from a wholesale supplier into a branded retailer. The focus was on strengthening its brand, maximising consumer focus to drive the retail business, developing operational excellence and exploiting global growth opportunities.

Despite the challenges faced during the financial crisis, the Permira funds' investment enabled the company to deliver on its growth strategy by providing supportive long-term capital and strengthening the management team, with the appointment of highly-experienced chief executive Claus Dietrich Lahrs, who joined from Dior. Under his leadership, the business worked on improving sales and earnings growth through delivering an ambitious store expansion plan, extending its product lines and developing a closer relationship with its consumers. The company also clarified its brand identity, built a strong organisational backbone and accelerated its global growth in emerging markets including China and South East Asia.

Following the sale of Valentino Fashion Group, the funds remain majority shareholders of Hugo Boss today. The company posted record sales of more than €2bn in 2011 and has continued to report strong growth since. Under the funds' ownership, its sales increased by over 46% from €1,632m in 2007 to €2,391m at Sept 2013 and its EBITDA almost doubled, growing from €275m in 2007 to €545m at Sept 2013. In 2013, Hugo Boss appointed Jason Wu as Artistic Director for Boss Womenswear while the CEO publicly reconfirmed his medium-term target for the company to reach €3billion of sales by 2015.

What is private equity?

Private equity is finance provided in return for an equity stake in potentially high-growth companies. Private equity firms typically look to invest majority stakes in underperforming companies that have the potential for high growth. Growth in the businesses is delivered by working with the company's management team to improve performance and strategic direction, making complementary investments and driving operational improvements. Private equity firms are long-term investors, typically investing in companies for around 5-7 years. This means a commitment to building lasting and sustainable value in the businesses they invest in. The only way to realise returns for investors is to sell a business in better shape than when it was acquired. Typically firms will sell their stake in a company by listing on the public markets or selling to a strategic buyer. Private equity raise funds to invest from sources such as pension funds, endowments and sovereign wealth funds.



3.5 Digitalisation of services

As companies look beyond economic recession to recovery, they face a double challenge: managing macro-economic uncertainty and digital disruption. The challenge for business leaders is to find new sources of growth and at the same time run their companies effectively, as digital technologies disrupt existing markets and allow in new players.

If Europe is to remain competitive on a global stage, it needs to harness the economic transformations and disruptions caused by the growth of the digital economy. Companies in general and those in innovative sectors in particular, suffer from the current fragmentation of the Digital Single Market (DSM) and, at times, from unclear rules. Defragmentation of the DSM is essential and the reward for defragmentation is growth. It is estimated that Europe could gain 4% GDP by stimulating development of DSM by 2020.

“ *It is in the interest of financial services that Europe has a vibrant technology industry and that the sector embraces new digital technologies. By doing so, the financial services sector will create differentiation that enhances customer choice.*

Digital technologies are disrupting the financial services market, most visibly in the payments sector where new technology players have begun to cut banks out of customer transactions, but on many other fronts as well. European banks should look at developments abroad. Alibaba, China’s equivalent to Amazon, now offers loans to its merchants and has quickly become the largest seller of money market funds in China, for example.

The good news is that many financial services across Europe recognise the opportunity digital provides. They are inventing and applying new digital technologies – mobile, analytics, cloud – sometimes in collaboration with other sectors, to provide new value added service and better ways to spend and save money.

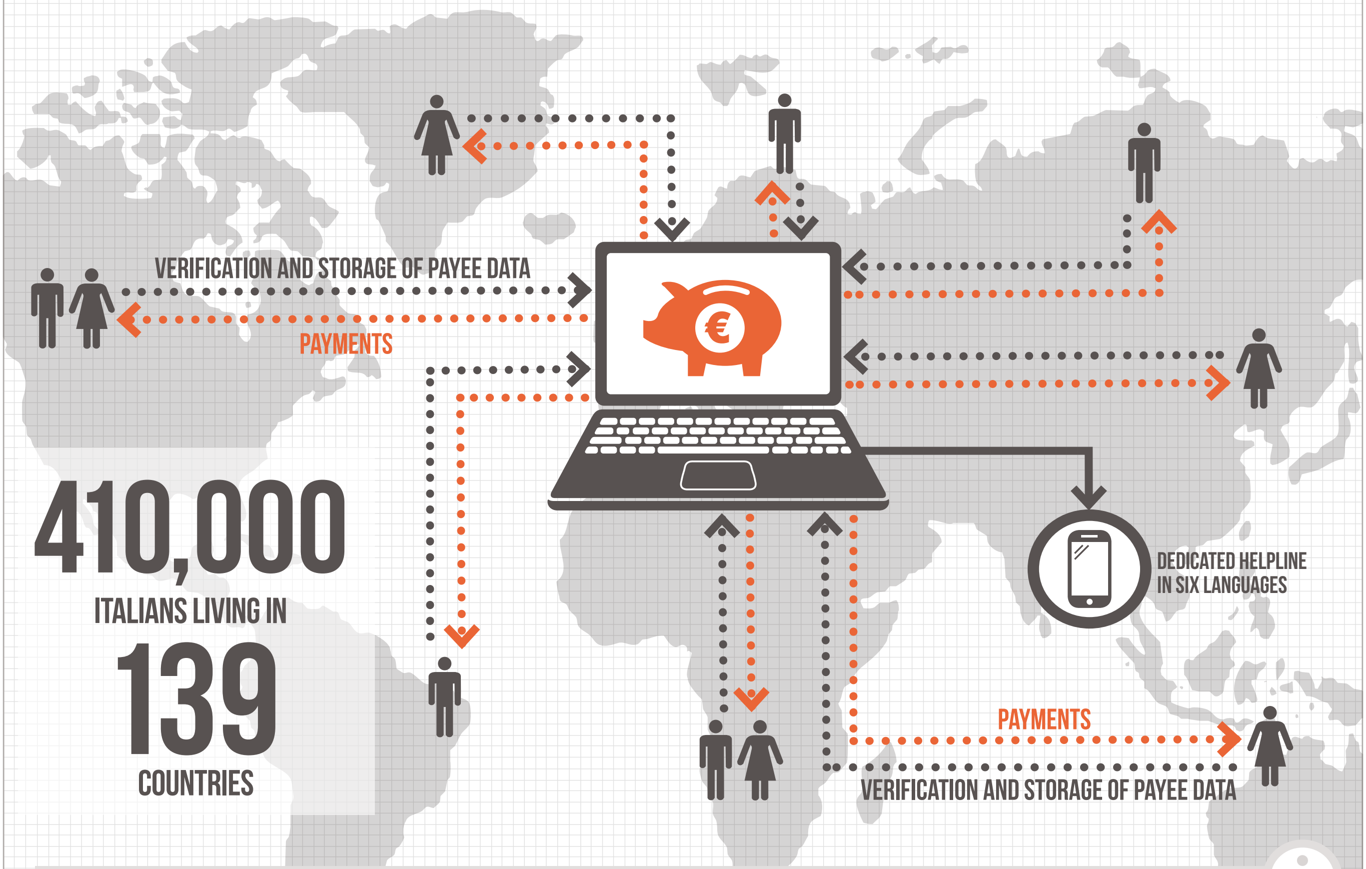
This is evident in the EMEA Accenture FinTech Innovation Lab London, which launched with major UK, European and US banks and participation from government organisations. The Lab promotes financial technology entrepreneurship – by helping SMEs incubate their ideas under the mentorship of top CIOs and CEOs from the major banks. The Lab is just one example of the importance the financial services sector places on digital disruption and the opportunities it promises industry and its customers. ”

Richard Lumb, Group Chief Executive – Financial Services at Accenture

DIGITALISATION OF SERVICES

Citi recently worked with the Italian government, which has the largest pension fund in Europe (in terms of paid pensions) to improve their management of international pension payments. Citi was the first non-Italian company to win the contract to manage the pension payments of 410,000 Italians living in 139 countries. In addition to being required to design a complex payment system, Citi was also requested to introduce additional value add services including Proof of Life certification, central pensioner database management and an interactive pensioner website. In addition, a dedicated helpline was established in six languages. The first round of 251,000 payments in 139 countries was successfully made in February 2012. Payments could be collected in a variety of forms, including account credit, cash pick-up and cheques.

This is an example of a less familiar function being provided by a financial services institution. While a relatively simple transaction for the payer and recipient, the infrastructure requirement to deliver such a large volume of payments to such a wide range of destinations is immense.



Governments and companies face similar challenges when establishing integrated, efficient and secure payments infrastructures, be it social welfare provision or employee payments. The receipt of such payments is often deemed to be a simple transaction. In reality there is a complex web of financial structures in place to make this work effectively.

This is made more complex when payments need to be made to recipients in multiple countries.

Governments are under pressure to streamline the provision of services and related payments to deliver better value for money. The policy environment is beginning to adapt to facilitate the digitalisation of social payments, statements and related administration. This shift can be supported by the financial services sector that has the expertise and resources to develop the necessary infrastructures. This can bring added social benefits by improving the delivery of essential payments such as state pensions.

4.0 A POLICYMAKING AGENDA FOR GROWTH

EU institutions, particularly the European Commission and Parliament, should make growth the cornerstone of the 2014 - 2019 mandate. From the earliest stages of legislation and regulation, the impact of policies on jobs and growth should be assessed. Policies should be strategic, consultatively made, evidence based and reviewed against other policies to ensure coherence. Existing policies which can support growth should be fully implemented, for example completing the Single Market in financial services to increase the pool of investment opportunities available to business. Policymakers should also place a greater emphasis on promoting growth when preparing new legislation. This is not a request for less regulation, rather it is a call for mechanisms that promote growth to be built into the design of legislation.

4.1 Growth orientated legislation

The legislative process can be adapted to make it more conducive to growth. The Commission engages with industry as it prepares legislation through formal consultations but often the final legislative proposal still contains measures that are damaging to growth. Potential issues could be identified and addressed if draft proposals were submitted for consultation. This would provide for a better assessment of a legislative proposal and for unintended consequences to be identified before the co-decision process.

Better impact assessments are essential if future legislation is to be designed to promote growth. The Commission should signal its intention to carry out far more robust impact assessments that focus on identifying the potential effects on the market, rather than simply assessing the one-off and recurring cost of the legislation.

Requiring legislators to provide a better examination of the impact on the functioning of the market will necessitate a far deeper assessment of the legislation and its practical effect. Similarly at Parliamentary level a mechanism should be considered that would allow for the legislative process to be put on hold and a second impact assessment carried out when a piece of legislation is substantially revised.

The co-decision process provides opportunities for stakeholders to present their views on issues but the volume of legislation has put policymakers under pressure to reach agreement at first reading. This has resulted in more substantial and less predictable amendments being made to legislation during the closed trialogue process, which can undermine the principles of good policymaking.

4.2 Completing the Single Market in Financial Services

Completing the Single Market in financial services can still deliver significant gains through lower funding costs for businesses across the EU and better access to capital and investment opportunities across borders.

As the mobility of people, goods and services continues to grow, it is important that policy and business practice keeps pace by protecting consumers' personal information and their transactions, as the digitalisation of services become more advanced. Legislative changes relating to data protection will be at the forefront of the 2014 - 2019 legislative term and ensuring their workability within the EU and with third countries will be important to enable the financial services sector to continue to deliver and finance integrated processing, payment and data storage solutions for companies and governments. The focus should be on completing the Single Market for goods and services that are easily tradable.

4.3 Delivering better returns to investors and more funding for businesses

Pension funds can face restrictions on the types of assets in which they invest through regulatory restrictions on investment opportunities in third country markets. While policymakers rightly prioritise the safety of pension fund investments, preserving the ability of investors to access high growth markets is also important. Pension funds have a variety of mandates and those catering for the people earlier in their career who may be less risk averse seek to access high growth opportunities. Similarly, channelling savings into Europe's future infrastructure projects is one of the most valuable functions performed by a pension fund and should be promoted as far as is possible.

Europe's businesses require a diverse range of funding sources to invest, grow and compete in global markets. Packaging SME loans into a securitised product can reduce the risk of SME investments and reduce financing costs for individual SMEs. Securitisation should be a priority for the next mandate. Promoting other forms of financing for smaller business such as private placement should also be considered.

4.4 Financing solutions for Europe's infrastructure

Continued co-operation between the public and private sectors is needed to ensure that infrastructure projects remain accessible for institutional investors and that innovative financing models continue to be developed.

Policymakers should facilitate further collaborations between the financial services industry and institutions such as the EIB in order to identify opportunities and alleviate blocks to infrastructure financing. Better co-operation is also needed between the different directorates in the European Commission. DG MARKT, DG CONNECT, DG MOVE and DG ENERGY all have an important role to play in setting infrastructure priorities and financing opportunities. Policymakers should also continue to review the calibration of long term assets under EU legislation to ensure that finance for infrastructure projects is not restricted.

The use of public private partnerships should be further expanded across Member States. Levels of use vary by Member State and it would be useful for policymakers to promote effective collaborations as examples of best practice.

4.5 Co-ordinating global regulation

By 2015, 90% of economic growth will be generated outside Europe, which is a compelling reason why Europe cannot afford to turn inwards or create regulation without considering its international context. The EU's own regulatory architecture has an impact on economic growth and the competitiveness of European businesses is affected by debates about financial reform at the G20 level. Policymakers must engage positively with the rest of the world to achieve openness and coherence between international markets and jurisdictions. Acting unilaterally to impose measures such as the Financial Transaction Tax has a negative impact on the EU's competitiveness and undermines both job creation and growth.

EU policymakers need to pursue these aims across multiple fronts, including bilateral, plurilateral and multilateral trade and investment negotiations. They should seek enhanced regulatory coherence and address other 21st century issues which will enable European businesses to maximise their competitiveness in the global economy. This is a significant area where the EU can exercise global leadership.

5.0 CONCLUSION

The priority for EU institutions in the 2014 - 2019 legislative term is to move the focus from repair to competitiveness and growth. Policymakers alone cannot achieve this objective. This report has outlined how the financial services industry delivers complex and varied solutions that generate real value in addressing the social and economic policy challenges facing Europe.

Fundamentals for growth	Role of the financial services industry
Competitive businesses	• Providing both mainstream and alternative financing options to all sizes of enterprises
A stable business environment	• Providing a wide range of services that create more stable and predictable operating conditions for businesses
World class physical and technological infrastructure	• Providing the capital, expertise and investment to make long-term investments possible • Providing new digital technologies through which people access financial services
Channelling passive investments into active savings	• Providing a deep pool of capital to meet Europe's business and investment needs and safeguarding the retirement incomes of future generations

In order for growth objectives to be achieved, the financial services industry needs to better align with policymakers' priorities. In turn, as shown in this report, policymakers can address many of Europe's economic and social challenges by fostering a regulatory climate that harnesses the full potential of the financial services industry to deliver the jobs and growth which Europe's people and businesses need.

GLOSSARY

A **bond** is a transferable debt **security** that can be issued by governments, corporates and financial institutions themselves to raise capital through borrowing.

A **derivative** is a risk transfer agreement, the value of which is derived from the value of an underlying asset. The underlying asset could be an interest rate, a physical commodity, a company's equity shares, an equity index, a currency, or virtually any other tradable instrument upon which parties can agree. There are three main types of derivative contracts:

a) **Over-the-counter ('OTC') derivatives** are customised, bilateral agreements which are negotiated privately between the two parties to the transaction and then booked directly with each other.

b) **Exchange traded derivatives ('ETD')** are listed derivatives that are traded over a centralised trading venue (known as an exchange) and then booked with a central counterparty (known as a clearing house).

c) **Cleared derivatives** are negotiated privately (like OTC derivatives) but booked with a clearing house (like ETD derivatives).

Hedging is a risk management strategy that protects the value of an asset against the risk of adverse price movements. Thus **interest rate hedging products** enable the management of fluctuations in interest rates by the use of derivatives such as **interest rate swaps**, which enable a party to 'fix' their interest rate by entering into an agreement with a counterparty to exchange interest rate cash flows.

The **primary market** is the market on to which new securities are issued for the first time.

The **secondary market** is the market on which existing securities are traded.

A **security** is generally a transferable financial instrument which represents an ownership interest in a corporate (also known as **equity security** or **stock**) or the debt of a corporate or government (also known as a bond). Other forms of debt can be turned into securities (through **securitisation**).

Senior debt ranks before other issues in terms of claims on assets in the event of an issuer insolvency. The word "senior" is used to describe ranking of a debt vis-à-vis other debts of the same issuer: for example, senior bonds issued by company A rank before **junior** bonds issued by the same company. It does not mean that the debt is necessarily secured or otherwise preferred if the issuer becomes insolvent but senior debt is not **subordinated** to other debts of the issuer. So, in the event of insolvency, junior (or subordinated) debt-holders receive payment only after senior debt is paid in full.

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