

# CAPITAL MARKETS UNION: FBF POSITION *Conditions and proposals*

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FBF welcomes the Capital Markets Union (CMU) initiative and the new priority to growth and employment. A proper financing of the economy is key to achieve these objectives. As a reminder, financing the economy, especially SME's is the number one strategic priority of French banks.

Prudential regulations lead to a reduction in the share of bank credit in the financing of European economies, and market financing is needed. Universal banks are and must be keys actors of this transition.

In this context, the new European legislation must seek to develop market financing that serves sustainable growth, employment and competitiveness in Europe, by relying on resilient European banks.

Europe must now make sure that the transition to a more diversified model is managed properly, including where the financing of SMEs is concerned.

This transition will take place at different rates depending on the market participants: the SME/ISE system is still largely reliant on bank credit, and will remain so. Proper attention must be paid to banks balance sheet regulation and management, in order to make sure we have enough credit to foster their development.

For those who can have access to market financing (and this must be made more and more open), universal banks are willing to play their role in accompanying their clients.

# NECESSARY CONDITIONS

FBF is recommending that certain prudential measures, or measures that still need to be taken, be assessed from an economic standpoint, in view of growth, employment, and competitiveness targets. The (low growth) economic and regulatory environment in Europe requires a methodology based on simple criteria (reducing the cost of fund-raising, the attractiveness of the markets, and improving liquidity by increasing market-making activities).

## Banking Structural Reform proposal: to preserve market-making

The adoption of the Banking Structural Reform proposal would have significant adverse impacts on the potential CMU. The separation of trading activities out of the universal bank would render market-making more expensive for customers and decrease liquidity in the markets. In this respect, it is also by considering the important role of intermediaries that the CMU can become a success, connecting borrowers/companies with lenders or investors.

The market maker model is vital for the financing of the economy and the functioning of markets. Market makers provide liquidity, enable market participants to trade smoothly in and out of positions without excessive price volatility, provide certainty of credit exposure and enable investor flows to raise financing. As recently highlighted by several studies<sup>1</sup>, increased regulatory requirements have already significantly reduced incentives for market makers to hold inventories and to provide liquidity services, ultimately contributing to increased volatility.

## Financial transaction tax

The proposal for a financial transaction tax at the EU level (FTT) constitutes a major obstacle in the way of setting up and developing the Capital Markets Union. Proposed in 11 of the 28 Member States, this tax creates distortions of competition and therefore



causes substantial tax fragmentation within the European Union.

The tax will have serious consequences for businesses by increasing their funding costs and restricting their access to market funding. Even with a very low tax rate, the effects would be considerable in a climate of globalised and keenly competitive businesses.

## For an appropriate harmonization of legislation

The Capital Markets Union should not be used as a “Trojan horse” to full harmonization of legislation as appropriate, a reconciliation of some national laws (e.g. for the French Euro-PP private placement), or the promotion at European level of best market practices can already be beneficial to the objectives of the CMU. In any case, it is necessary to avoid the CMU being built based on a too globalised concept of law, at the expense sometimes of continental rights.

1. CGFS report on market-making and proprietary trading, IMF Global Financial Stability Report, Joint Committee Report on Risks and Vulnerabilities in the EU Financial System, etc.

The CMU can only succeed if some parts of existing or planned legislation that contradict it are revised or adjusted:

- Some capital or liquidity requirements for banks (CRD IV, recalibration of NSFR);
- Structural reform of banks;
- Revisit the planned financial transaction tax in 11 member-countries;
- Some capital requirements for investors (Solvency II);
- Some financial disclosure requirements for issuers (prospectus, transparency);
- Adjust securitisation requirements to promote securitisation with a CRR revision<sup>2</sup>;
- Take MiFID's impact on research into account at level 2.

If this is not the case, European banks, as far as market-making activities are concerned, would not be the principal player in this development.

### Importance of taking into account the functioning of financial markets

In this tough environment, CMU could be highly beneficial: attractiveness of the European Union for investors, diversification of financing instruments, cost reduction, better allocation of resources, and greater resilience of the economy in the event of a shock. It will need to take the monetary zone in which it operates into account, as well as the ini-

tiatives that supplement it, i.e. the European Commission's investment plan and the ECB's asset purchase facility.

The CMU draft proposal must contribute to safeguarding the financial stability of the CMU. This means that the consequences of the fragmentation of the European Financial Market with other countries that have different currencies should be assessed and managed, particularly risks related to netting of transactions for example in stress scenarios.

This means specifically that we need to understand how eurozone infrastructures that are paramount for this market, and expensive for those who contribute to maintaining the said infrastructures, are protected and not unduly called upon.

This also entails relations with third countries also being assessed in light of the management of financial risks. This clearly raises the question of the scope of CMU and its possible extension, in one form or another, to third countries that would be involved.

This finally raises the question of the conditions for prudential control of non-European banks operating in Europe and managing liquidity and capital adequacy risks.

There is the need to attract more investors to the market, with a view to long-term investment.

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*2. Regarding this point, the Basel Committee still seems reluctant.*

## CONCRETE PROPOSALS

### Create a common label for safe and transparent securitisations

This label based on transparency and security would receive special prudential treatment so that it is closer to the applied state guarantee in the US. Like the US model, which is supported by public agencies, the EIB has set up instruments to leverage private capital, particularly by securitising exis-

ting assets. Cooperation with major European institutions should help enhance resources for suitable infrastructure by using special co-financing mechanisms (in this case "securitisation funds").

For securitisation of small and mid-sized companies, the EIB could be involved at the underwriting level, just like some member-countries' national institutions. The guarantee on small or large projects should make them more attractive to investors:

- The ECB could buy these tranches, thus providing the necessary liquidity for securitisation to develop at a healthy rate;
- For real-estate securitisation, a European label is also a good idea;
- And, lastly, the creation of a public 'Fannie Mae-like' institution could be considered, in cooperation, where applicable, with national institutions (CDC, KfW, etc.) or European ones (EIB), which could also take over from it.

### Develop a European Euro-PP market

Companies' euro-denominated private placement options should be developed, particularly those of mid-sized companies, by establishing best practices able to draw in international investors.

### Promote a euro-denominated negotiable debt market

This would mean developing standards and practices at European level for this market, which is a core mechanism in short- and medium-term corporate financing. Care should be taken to keep the proposed regulation on money-market funds from affecting its operations.

### Set up a common framework that fits small and mid-sized companies

With this in mind, a transversal text whose objective is to ease market access for small and mid-sized companies must be developed with its key principles being:

- facilitation of market listings by setting suitable obligations for such companies with regard to the framework currently set by the Prospectus, Transparency, Market Abuse directives and other directives, which limit related costs, etc.;
- the retaining and expansion of tools that are vital for the functioning of markets and are accessible to small and mid-sized companies, in particular market-making and production of research (financial analysis).

### Develop solid market infrastructures

The current architecture of market infrastructures within the Single Market is the result of the progressive adoption of dedicated legislation over 2 decades harmonizing the various layers of the securities chain. Each layer was conceived and modernized independently without strategic thinking embracing the full chain. With one exception, every time a market infrastructure was under discussion, the guiding principle has been to open up the provision of services by this infrastructure to competition. The assumption being that running such an activity is a profitable business even if offered by several operators.

Finally, a discussion has started on the merits of creating an EU-wide consolidated tape aggregating trading information from the various trading venues - the choice was made to wait and see if such a consolidated tape can be operated by a private sector entity.

In accordance with the choice made to leave the running of market infrastructures to competing operators, the EU has established the principle of open access to such infrastructures and has tried to promote interoperability mechanisms permitting an EU-wide connection between the various kinds of platforms.

By comparison, some other jurisdictions have made the choice to treat certain market infrastructure layers as "utility"; for example, in the US, for certain kinds of financial instruments there is a mutualized consolidated tape, a unique clearing house, one central securities depository and a single trade repository.

Some market participants advocate a holistic evaluation of the current EU market infrastructure architecture to measure its overall efficiency and the appropriateness of the "competitive vs. utility" choices made for each layer of the securities chain.



For the FBF, the implementation of T2S must be continued, along with the harmonisation of clearing and settlement/delivery systems. For reasons of systemic risk and regulatory arbitrage, prudential regulations must be developed for clearing houses. And, lastly, when these infrastructures operate in euros they should be domiciled in the eurozone. It will be possible to implement T2S in a harmonized way, ensuring what is done elsewhere in the industry.

It is therefore important to maintain multiple financial markets rather than seeking at all costs to keep a single market. In some cases, reconciliations of several market infrastructures would generate economies of scale that can reduce market access costs for businesses. Indeed, it must be recognized that some projects would not make sense to scale enough homogeneous areas, whether in legal (bankruptcy, securities, etc.) or currency terms. Harmonisation on a case by case basis.

### Contribute to the development of long-term European investors.

Firstly, it is important to mention that, where retail banking operators are concerned, the French long-term investment issue is primarily reflected in a lack of demand from project backers, and is often reflected in the inadequate profitability of long-term investment projects, rather than in a lack of financing solutions for a profitable project backed by solvent operators.

The development of European markets requires a critical mass of long-term investors. This task, which was begun by the previous Commission, must continue to promote the emergence of long-term investment funds and requires prudential adjustments (CRD IV and Solvency II).

### Practical measures: adapting the prospectus directive

It should facilitate the raising of capital in the markets by companies, notably SMEs, while at the

same time maintaining comprehensive information, a condition of the European Union's attractiveness for European and international investors is necessary:

European harmonisation of the thresholds for exemption from the requirement of a prospectus, as well as the adaptation of certain thresholds in order to take account of the reality of the market,

- Prospectus exemption for certain "secondary issues" of equity or debt securities carried out by companies already having their securities admitted for trading in the markets (since investors already have sufficient information to take their investment decisions),
- The non-extension of the prospectus requirement for admissions to trading on MTFs (e.g.: Alternext), in order to take account of the differences between regulated markets and MTFs and protect SMEs from additional costs and constraints.

Its content:

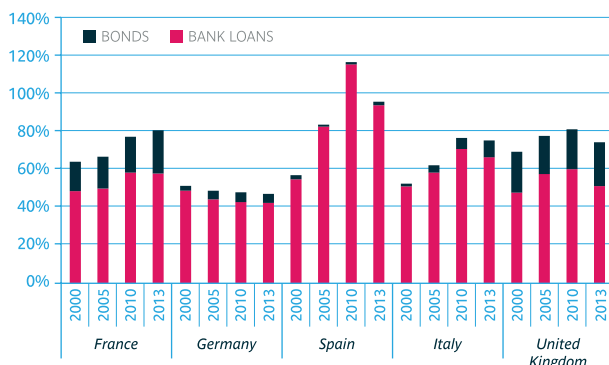
- A reduction in the prospectus content for certain issues in regulated markets and the implementation of an ad hoc information document for issuers (SMEs and ISEs) soliciting savings outside regulated markets, with a harmonisation of the definition of SMEs at European level ;
- "Incorporation by reference" in the prospectus of information already published or approved by the authorities, in order to reduce its content, conditional on investors having easy access to this information ;
- Better delimitation of the Prospectus and PRIIPS ("Packaged Retail and Insurance-based Investment Products") provisions and exemption from the obligation to draw up a prospectus summary for products that are included both in the scope of PRIIPS and the Prospectus Directive and are subject to the obligation to draw up a KID ("Key Information Document").



## KEY FIGURES FOR CMU IN EUROPE

### Financing of European companies focused primarily on loans

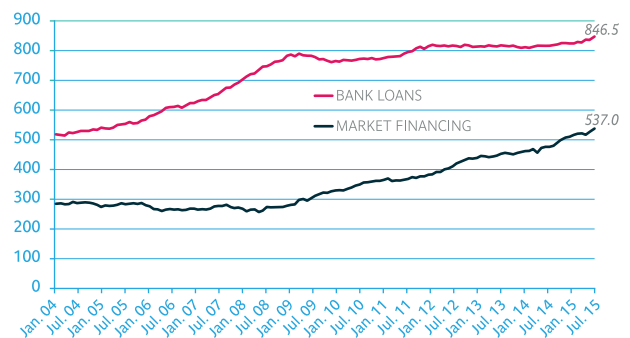
FINANCING OF NON-FINANCIAL COMPANIES  
VIA BANK LOANS AND BONDS (as a % of GDP)



Source: Eurostat, Domestic financial accounts (balances, consolidated data)

### Disintermediation in France: Development of financing via the markets since 2009

TREND IN BANK LOANS AND MARKET FINANCING  
(€ billion)



Source: Bank of France

### French banks among the most active European banks in the markets

TOP 11 EUROPEAN BANKS WITH TOTAL TRADING ASSETS

Ranking	Bankname	Amount trading Assets
1	Deutsche Bank AG	933
2	Royal Bank of Scotland Group Plc	751
3	Barclays Plc	710
4	<b>BNP Paribas SA</b>	684
5	HSBC Holding Plc	500
6	<b>Société Générale SA</b>	420
7	<b>Crédit Agricole Group</b>	346
8	Nordea Bank AB	207
9	Banco Santander SA	155
10	Commerzbank AG	133
11	<b>Groupe BPCE</b>	129

Source: Commission services, June 2015

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