Comments

by the German Banking Industry Committee[1] on the Draft Report of the European Parliament's Committee on Economic and Monetary Affairs regarding long-term financing of the European economy

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The **German Banking Industry Committee** is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks finance group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,000 banks.

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I. Introduction

In response to the Green Paper entitled "Long-term Financing of the European Economy" submitted by the European Commission in March 2013, on 5 November 2013, the Committee on Economic and Monetary Affairs of the European Parliament (ECON) published its draft report on long-term financing of the European economy.

II. Comments

The German Banking Industry Committee agrees with the draft report in that long-term investments are of pivotal importance for economic growth and the creation of jobs. Hence, we welcome the fact that access by companies to long-term funding has been put on the agenda by European policymakers as an official policy objective. A sufficient supply of longer-term financing is an indispensable foundation for sustainable growth in the economy. At the same time also the commitment of the Member States in favour of a solid budgetary policy is crucial.

The experience in Germany during the 2008/2009 economic crisis has shown that stable relations between clients and their house bank (in German "Hausbanken", the key relationship bank of a client) are vital especially for the availability of long-term financing. When funding long-term investments, SMEs trust in "house bank loans". It is worth noting that the UK, previously marked by a strong focus on capital markets, has seen the emergence of an enormously strong interest in the German house banking system.

On the whole, we do not concur with the view that the historically heavy reliance on bank financing obstructed the financial intermediation process. At EU level, policymakers have criticised the high ratio of banking loans in corporate funding. This led to a call for more funding through the capital market. Yet, this is not warranted by realities on the ground in Germany and other EU Member States featuring a well functioning corporate funding sector. For most SMEs, funding through capital markets is too time consuming, too expensive and incurs excessively stringent requirements/strictures (e.g. minimum volumes, reporting obligations). An arbitrary promotion of financing through issues in the capital market with the objective of weakening the role of banks involves the danger of ignoring companies' real needs and expediting the emergence of so-called shadow-banking activities which lack a comparable degree of regulation. This potentially jeopardises stability and is incompatible with the EU's objective of regulating or, moreover, reducing shadow banking activities. For SMEs, investments funded by bank loans are more constructive. For instance, in Germany (which features a generally higher share of bank debt-funded investments) there were not the least signs of a credit crunch - neither for the SME sector nor for the public sector. Even if access were to become easier, especially for SMEs, the cost of corporate finance through the capital market would never be able to beat the cost of conventional bank debts. For companies, heavier reliance on funding by means of capital market instruments is already an option today and they draw upon this possibility – if and when appropriate. At this juncture, facilitation by universal banks i.e. "one-stop-shop" support has been tested and tried for decades; hence, also in the interest of SMEs, this approach should not be abandoned. The ECON's draft report welcomes the fact that the US features a high ratio of capital market financing. From our point of view, this fails to recognise the extremely negative developments triggered during the financial crisis especially by capital market transactions.

Some parts of the EU are experiencing a credit crunch in the area of long-term loans. These problems are due to the currently high economic volatility and the limited capabilities of the banking systems in the peripheral states as well as due to the unusual interest rate environment which is the result of an extremely expansionary monetary policy. At the same time, a loss of confidence can be observed among investors that only partly can be explained by the loss of confidence within the financial industry.

In order to re-establish the readiness of private individuals and enterprises to make long-term investments it is of crucial importance that the EU and individual Member States achieve further progress in solving key economic policy problems, especially on consolidating state debt.

So long as, on account of the unabatedly critical situation, major uncertainty prevails concerning the future economic development and risks of inflation or deflation, depositors and investors will react only with great restraint to political expectations on long-term commitment.

Against the background of this key problem, the EU can best promote efforts towards consolidation with simultaneous strengthening of growth by citizens and businesses, by using the resources available to it to support reform efforts by the Member States. It is only if the reform efforts are successful that the ECB can re-emerge from crisis mode.

ECON's draft report assumes that, also in future, the banking industry will constitute an important source of finance. We share this view. In our opinion, banking loans will remain the central form of corporate finance also in the future. Based on the foregoing, we endorse the request to the EU Commission to carefully analyse the aggregate impact of the work in progress as well as those measures already adopted in the area of financial regulation for longer-term investments. We concur with the European Commission's statement contained in its Green Paper on "Long-term Financing of the European Economy" that the detailed calibration of the new regulatory and supervisory framework must effectively enable and incentivise the financial sector to support the real economy, without jeopardising financial stability. In this respect, it is also important to examine the multifarious regulatory plans on the stabilisation of the financial sector and at the same time to create regulatory framework conditions for a stable financial sector.

As regards the long-term financing of the European economy, there should be a clear differentiation between finance for SMEs and investments into long-term projects (e.g. infrastructure projects or the green energy turnaround). This distinction also has an impact on the definition of the term "long term", as well as on possible investors who are interested in financing. As far as the investors are concerned, a separation should be made between "equity investors" and "debt capital investors".

The European Commission correctly recognises that national and multilateral public development banks - considering that they are committed to the pursuit of specific public policy objectives - can be useful in stimulating private financing. In our view, promotional structures that have been tested and established in the Member States (including the German public development banking system at both regional and federal levels) should become involved in this process.

The ECON draft report and the EU Commission express the view that (given the more long-term nature of their business models) institutional investors such as insurers, pension funds, investment funds and foundations are suitable as providers of long-term financing. In this respect, we hold the view that there is a need to shore up this alternative system of financing and to create a level playing field during the regulatory process in order to avoid the emergence of further shadow banks. Additional instruments for long-term financing should only be developed if and when the investor groups receive equal treatment.

We concur with the view expressed in the draft report that funding instruments such as covered bonds require further improvement. In many countries, also during the crisis Pfandbriefe / covered bonds were instrumental in avoiding a credit crunch for the real estate sector concerning long-term finance. On the other hand, any attempt at a revitalisation of the ABS markets shall and must initially be based on the existing regulatory trend. Hence, the subsequent regulatory proposals should be reviewed in light of their underlying rationale and potentially ought to be abandoned if need be:

- The more stringent capital requirements for banks
- No eligibility in the LCR (except for derogations)
- Higher ECB haircuts or
- The envisaged capital requirements for insurance undertakings (Solvency II) scheduled for 2016 which will disqualify insurers as potential ABS investors

A broad-based revitalisation of the securitisation market in Europe will be virtually impossible in the absence of measures to counterbalance the regulation and its complex interaction with other capital market instruments.

Regarding the potential availability of venture capital as an alternative source of financing for high-risk investments, it is worth noting that banks and insurance undertakings act as financial intermediaries and that they are experienced institutional investors. This begs the more fundamental question as to whether, in the regulatory field, a simplification must be made in order to create incentives again which allow credit institutions and insurance undertakings to become involved in the field of venture capital.

Crowd-funding is an interesting product as a "non-traditional" source of financing. However, on a more critical note, it is worth pointing out that these are risky investments which are usually only suitable for experienced investors. At present, these funding models lack investor protection rules. The "crowd" includes all operators, i.e. also those with little or no experience. It is open to doubt whether these are the right venture capitalists for seed investments. In general, with regard to crowd investing there is still a considerable need for further research.

On the whole, a deliberate promotion of alternative non-bank sources of finance poses a major danger to financial market stability. In lieu of such a promotion, also in the framework of the future regulation it will remain crucial that banks are capable of offering their customers those corporate loans and financial services which they demand thus strengthening a banking relationship that caters to the needs of SMEs whilst simultaneously preserving its local roots. This is ensured by the house bank principle.