

PORTUGUESE FINANCIAL ASSOCIATIONS GENERAL REMARKS ON THE GREEN PAPER “BUILDING A CAPITAL MARKETS UNION”

1. Moving towards a Financial Markets Union

If properly designed, a Banking Union and a Capital Markets Union can together create an integrated and efficient Financial Markets Union. The focus must be placed on the promotion of overall financing in the E.U., and not in substitution effects of funding sources. Stronger capital markets will leverage bank lending if the promotion of complementary financing options is designed to address financing gaps (namely the equity gap in Europe and first stage financing) while simultaneously preventing competitive distortions for the banking sector. The overall benefits for the wider economy of the possible, and desirable, multiplier effects between capital markets financing and bank based financing will, however, require regulatory compatibilization/harmonisation in a coherent approach and, ultimately, may depend on the recalibration of cumulative regulatory requirements applicable to the banking sector.

2. Restoring confidence and promoting responsible risk-taking

Rebuilding trust in the single currency project is paramount to the Capital Markets Union project. The focus should be on mitigating the lack of confidence and simultaneously changing the climate of risk aversion, which are central factors common to agents in the financial system and to mechanisms and channels for financing the economy.

To achieve these objectives, actions on multiple fronts are required, including (i) addressing financial stability issues, (ii) promoting regulatory stability, (iii) increasing the transparency, reliability and comparability of information, and (iv) promoting the financial education of investors.

Only after these issues are properly addressed, will it be possible to promote investments in asset classes with higher risk and longer maturities (e.g. equity) and to achieve substantial levels of economic risk sharing, using well-integrated and deep capital markets.

On a country-level basis, risk mitigating policies aimed to redirect risk appetite beyond high grade investments, to peripheral countries and at a price consistent with these economies growth capacity, may prove to be important.

3. Addressing SME financing needs

The European economy is dominated by SMEs. This reflects not only history and culture, but entrenched rules that discourage firms from expanding and owners from selling. The concept of SMEs covers a broad range of businesses that seem not to be fully taken into account in the Green paper. We would highlight the fragmented universe of small and micro enterprises for which the bank intermediation is crucial for reasons of reduction of information asymmetries and efficient credit assessment and monitoring. This segment, now and in the future, largely surpasses the range of SMEs that have the expertise and the means to regularly access capital markets.

The majority of Portuguese SMEs - as it is the case for the majority of European SMEs - are not yet qualified administrative and financial organisations; they favour informal relationships, present fragile financial structures and operate in a context of a high interdependence between the business and personal sphere with a strong family succession mentality and, sometimes, unwillingness to lose control of the business. This generates substantial competitive disadvantages in terms of reporting, transparency, accountability, intrinsic risk, governance procedures, financial sophistication and external visibility.

Consequently, mechanisms that reduce these disadvantages will be useful in offering them greater funding capacity.

The use of rating services, high quality accounting standards for comparability purposes, legal certification of accounts, information disclosure databases, investment in the recapitalization of companies, high-level training and qualification of human resources and the use of support services in relations between companies and financial investors would substantially mitigate SMEs' funding difficulties.

Once these problems are addressed, the CMU may provide effective financing options for SMEs. namely regarding listing opportunities on SMEs Growth Markets (SME-GMs).

4. Ensure a level playing-field

The Commission must ensure a level-playing field for all financial market players. Channels of funding complementary to bank intermediation will be essential to create a CMU. However, these channels must be appropriately regulated. The so-called ‘Shadow Banking’ activities should not benefit from preferential regulatory treatment, but should be subject to the principle of ‘same risks, same rules’. The danger of systemic events associated high leverage and maturity, liquidity and credit transformation must be duly taken into consideration.

5. Holistic review of the financial markets regulatory framework and completion of the Single rulebook

A systematic and detailed review of the financial markets regulatory framework, across all different regulations and regulatory authorities should be conducted. This review, while taking into consideration the different objectives of the existing regulations, should aim at identifying instances of regulatory duplication, gaps, and conflicts.

A successful approach to regulation of a capital markets union has to focus on streamlining legislative initiatives, ensuring a higher degree of harmonization between the different national legal and regulatory frameworks and in managing substantial risks rather than trying to eliminate risk altogether.

Where market-led initiatives are able to overcome or mitigate the limitations visible in the EU capital markets, these must be strongly promoted. Market-led initiatives are able to take into account the different risks, activities and business models within EU capital markets. Conversely, legislative measures must be regarded as a second best solution, because they can lead to serious unintended consequences and further fragmentation of capital markets. Some of the problems and flaws identified in the green paper are in part consequences of regulatory changes.

Member States must avoid “gold-plating” legislation, which is not supportive of a true single market project. Member States should not be competing on legislation, but instead should be competing on business-friendliness and reliable environments to attract investment.

The Capital Markets Union has to be built on financial stability, completion of the Single rulebook, high level of investor protection and confidence; investment attraction and solutions to untackled Giovannini barriers.

6. Adoption of tailored approaches

A “one size doesn’t fit all” approach must be considered for the CMU project. We need different approaches for different markets and different approaches for different distribution networks.

Initiatives in the CMU domain must consider the different cultural, economic and legal frameworks in the EU jurisdictions. Disproportionate measures may lead to serious unintended consequences and further fragmentation of capital markets. Particular consideration should be given to preserve innovation and the ability of the financial services sector to provide consumers with products tailored to their specific needs. We see initiatives of product standardization under the so called “single market for retail financial services” as unnecessary and undesirable. Market solutions geared towards member states specificities and consumers particular needs should prevail over “one-size-fits-all” legislation initiatives.

7. Implementation of the Financial Transaction Tax (“FTT”)

One of the main barriers, which has not been implemented yet, but will surely limit the possibility of implementing an effective capital markets union, is the implementation of the Financial Transaction Tax (“FTT”).

The implementation of the FTT, even if limited to 11 Member States, will have severe negative effects on specific entities, products, activities and transactions, which, we believe, clearly demonstrate that the tax hinders the possibility of achieving the goal of establishing an effective capital markets union. In addition, the implementation of the tax on a subset of EU countries will lead to the relocation of transactions to non participating EU member states, which do not implement the tax, and to other international financial centers.

Among others, the following will negatively be affected by the FTT:

- UCITS and pension funds, which play a very important role in investment and savings by individuals and is one of the main concerns presented in the green paper;
- Sovereign debt, which will be taxed on the secondary market, which means less liquidity on public debt markets and increased demand for short term products instead of long term products;
- Increased funding costs for both the public and private sector in Member States that implement the FTT, because higher yields will have to be offered in order to compensate the tax to be paid;
- Increased costs for exchange of collateral and for risk management, which is contrary to the objectives established in the green paper;
- Increased costs for market making activities, which means there is a high risk that the FTT will severely hinder the liquidity of public debt markets;
- Temporary assignment of securities, including securities lending and repos, which means that these transactions will very likely be replaced by unsecured loans;
- Asset management activities, where the transaction is carried out on behalf of others, which means that the manager, that has no direct economic benefit from those transactions (other than the fees for services rendered), will be taxed for it;
- Sale and exchange transactions carried out within the context of a takeover (either voluntary or mandatory) of listed companies, because the FTT will necessarily affect the bid price, making such offers, on the one hand, less attractive or more costly to the potential buyer and, on the other, less favourable to minority shareholders, which will receive a lower exit price per share.

8. Effective but feasible reduction of overdependence on external ratings

The effective reduction of overdependence on external ratings has to be achieved. External ratings have become close to unworkable since the crisis in Europe because of major problems created by ratings agency's practices. These problems are (i) ratings volatility, due to methodology changes, sovereign ceilings, counterparty caps and triggers; (ii) lack of transparency of ratings agencies approaches; and (iii) inconsistency with regulatory risk evaluations.

European legislation on UCITS and AIF banned the possibility of exclusive or mechanistic reliance on external ratings, forcing management companies to make their own risk assessment. Yet, this should not be understood as an obligation that asset Managers must be converted into rating agencies or that they need to have a team dedicated to that end. Asset managers should be granted enough flexibility to evaluate the credit quality of their investments according to their own methodology, which should be adjusted to the structure of the company and to the nature of its investments.

9. Promotion of the countercyclical role of institutional investors

The historical countercyclical role of insurance and reinsurance companies and pension funds has changed significantly in recent years due to regulatory and accounting changes that lead to an excessive focus on the short term. In particular, Solvency II regime, applicable to insurers, should include a definition of infrastructure, as well as a review of the standard formula for both infrastructure and debt equity investments. In fact, the capital charges for infrastructure should be reviewed in order to minimise any disincentives to long-term investment.

10. Create incentives for a dynamic pension 2nd Pillar

Currently, throughout Europe, governments who still have such systems are struggling to maintain the sustainability of their PAYGO public pension systems, mainly by reducing the benefits provided by those systems or by delaying the access age to the pension.

Public pension systems should evolve, at least partially, to a capitalization system, where companies and employees contribute to private occupational pension schemes,

balancing the different pillars of the social pension systems and rightly sharing the risks (for instants, longevity and market risks).

Additionally, employers should become aware of the need to implement supplementary pension plans for their employees. This could be achieved by introducing tax incentives to companies that create such plans or by making mandatory the creation of such pension schemes and the contributions for them.

11. Development of a harmonized regulatory framework for Individual Pension products / the Portuguese evidence.

It urges to draw the attention of European citizens to the need of saving for their retirement and, at the same time, to create incentives, to increase the awareness and influence Europeans to build their own Personal Pension Plans.

In Portugal, we have an individual pension product whose primary objective is to capture individuals' savings for retirement and can be used as a model. In fact, this financial product can be wrapped as insurance products, Investment Funds or as Pension Funds but follow similar rules, namely prudent rules for portfolio composition, portability, and access to benefits. As experienced in the Portuguese market, it is possible to launch a harmonized regulatory framework at EU level for this kind of products, which does not undermine innovation and product design.

12. Revitalization of the securitisation market

The major obstacle to the revival of a healthy securitisation market in the EU is the excessively conservative capital requirements. The current framework bases capital charges on agency ratings. The criteria that agencies employ in assigning ratings have become significantly more conservative since the crisis. As a result, capital requirements post securitisation in the EU are considerably higher than those for underlying assets – discouraging securitisation as a financing technique. The US Dodd-Frank act precludes the use of ratings based capital formulae by US banks, whereas regulatory practices in Europe mean that the vast majority of European banks must use the ratings based approaches. As a result, there is a very uneven playing field between European and US banks. The adoption of a European simplified supervisory formula

approach would overcome the obstacle that external ratings pose to EU securitisations and would contribute to an urgently needed revival for the securitisation market in Europe.

Also extremely important is the ongoing development of a market segment of simple, standard and transparent securitisations. This must be based on a dedicated European securitisation framework addressing the lower inherent risks associated with this type of securitisations.

13. Preservation of liquidity and market-making

The CMU success will depend on whether or not markets can be made broader and deeper and on the availability of the necessary liquidity. Market-makers and intermediaries serve a decisive role in financial markets by providing liquidity to facilitate market efficiency and functioning or ensuring that both sides of the financing market are able to meet.

The ongoing bank structural reform proposal should be amended, to decrease the negative impact separation measures will have in terms of market liquidity reduction and cost increase, for both the credit institutions as well as to the retail and businesses customers it supports. Market making activity should be preserved. Regarding proprietary trading, the focus should be on separations, instead of bans.

14. Increase the enforceability and the fluidity of collateral

The increasing role of central banks, regulations and collateral custodians is significantly changing the collateral landscape. The adoption of a Collateral Directive would promote the legal enforceability and the fluidity of collateral.

15. Creation of a quality label for (non-listed) money market instruments

UCITS funds may invest in non-listed money market instruments, as long as they verify the conditions expressed in article 50(1) (h) of Directive 2009/65/EC (UCITS IV Directive). It would be very important if the European regulators, when approving the issue of (non-listed) money market instruments could verify if the instruments meet the

conditions of article 50(1) (h) of Directive 2009/65/EC and allow that the Prospectuses of those instruments include a stamp of eligibility for UCITS Funds.

16. Increased harmonisation of company and insolvency law frameworks

Company and insolvency law frameworks are based on different legal systems that are embedded in individual countries' legal history, culture and procedures. Consequently, these frameworks are characterized by considerable diversity and complexity. A greater degree of harmonization across the E.U. may contribute to the success of the CMU project, and aspects such as shareholder rights and subordination of debtor claims may merit special attention.

However, the Green Paper does not explain the problem that greater harmonisation of insolvency law would be supposed to solve and we find the assumption that action is needed a too premature one.

We believe that there is a need for further analysis before any proposals could be considered and so it would be premature to assume that harmonisation is needed.

17. Improvement of financial education and knowledge

The Commission should take steps to improve the level of financial education in the EU, for both retail investors and companies. This would help investors to better understand the functioning of capital markets and their role within markets, while companies would benefit from increased knowledge of possible funding options available within capital markets.

18. Training and professional certification of financial service providers

It is understood that the CMU will also require the growing recognition of the importance of training and professional certification of financial service providers, particularly those professionals who establish relations with clients and non institutional investors and who provide financial advising or financial planning services to those clients and investors.

This understanding has as its basis in the recognition of the growing need of protection of investors and consumers in financial transactions and the corresponding requirements of suitability and professional qualifications for financial service providers. A CMU with more requirements regarding conduct of business has to be built upon a training and education framework also appropriate to professionals.