Finance Watch response to the European Commission green paper on Building a Capital Markets Union

Brussels, 13 May 2015

Finance Watch is an independent, non-profit public interest association dedicated to making finance work for society. It was created in June 2011 to be a citizen's counterweight to the lobbying of the financial industry and conducts technical and policy advocacy in favour of financial regulations that will make finance serve society.

Its 70+ civil society members from around Europe include consumer groups, trade unions, housing associations, financial experts, foundations, think tanks, environmental and other NGOs. To see a full list of members, please visit www.finance-watch.org.

Finance Watch was founded on the following principles: finance is essential for society and should serve the economy, it should not be conducted to the detriment of society, capital should be brought to productive use, the transfer of risk to society is unacceptable, and markets should be fair and transparent.

Finance Watch is independently funded by grants from charitable foundations and the EU, public donations and membership fees. Finance Watch has received funding from the European Union to implement its work programmes. There is no implied endorsement by the EU or the European Commission of Finance Watch's work, which remains the sole responsibility of Finance Watch. Finance Watch does not accept funding from the financial industry or from political parties. All funding is unconditional, vetted for conflicts of interest and disclosed online and in our annual reports. Finance Watch AISBL is registered in the EU Joint Transparency Register under registration no. 37943526882-24.

Only the questions that are most relevant to Finance Watch are reproduced here.

For further questions, please contact Frédéric Hache, head of policy analysis at Finance Watch at frederic.hache@finance-watch.org.

Before answering the questions of the green paper, we would like to make a few general remarks. The Capital Markets Union initiative is based on a number of assumptions, some of which are a source of discussion.

a. Assumption 1: The lack of growth and job creation comes from a lack of credit supply, therefore we need to boost the supply of credit and capital markets.

There is a wide consensus[1] on the fact that the lack of growth comes for a large part from a lack of aggregate consumer demand, itself linked to structural factors such as the rise of inequalities over the past decades. Yet the political response is focused on supplying more credit to the economy and does not address this issue. **Complementary national and European political measures aimed at addressing the lack of demand** by increasing the purchasing power of low and middle classes are in our view necessary to achieve the objectives of sustainable growth and job creation.

b. Assumption 2: The European economy is too reliant on banks, especially compared to the US.

We note the strong desire to transform the European model towards a US funding model where capital markets play a bigger role. It has been amply demonstrated[2] however that the structure of a financial system - whether it is bank based or capital market based - is secondary from a growth perspective. In this respect it is not clear that the growth differential between the EU and the US is directly linked to the development of their respective capital markets. More generally this questions the idea that policy makers should aim at promoting one over the other and that this would have a beneficial impact on growth. **We therefore do not see a compelling need to change the European model**.

In addition, the green paper describes how the reliance on bank lending makes the economy vulnerable to a tightening of bank lending. Yet, **a higher reliance on capital market financing would in turn make the economy more vulnerable to a tightening of capital markets' risk appetite** and liquidity, arguably an even bigger risk given the markets' well known manic depressive behaviour.

We do not oppose bank lending and capital market financing and recognise that both have a role to play. It is important however to promote the most useful channels and models. In this respect, the crisis has shown that traditional relationship banking was more robust and more focused on lending to the real economy than the activities of large universal and investment banks. Yet by promoting a revival of securitisation the European Commission is implicitly promoting the latter model which required in some cases huge bail-outs. We believe on the contrary that **retail funded traditional relationship and local banking should be promoted as a priority**.

Lastly, the suggestion that promoting capital market financing will make our financial system more robust is also debatable in our view. A revival of securitisation, the related promotion of the investment banking model and reaffirmed central role of collateral are instead likely

[1] The Davos forum and the OECD acknowledge it among others.

[2] IMF, *Market Phoenixes and Banking Ducks - Are Recoveries Faster in Market-Based Financial Systems?;* Levine, R., *Bank-Based or Market-Based Financial Systems: Which is Better?*

to make our financial system more procyclical and interconnected, as we explained in a recent position paper.[3]

c. Assumption 3: By freeing up bank balance sheets, securitisation will increase the supply of loans, in particular to SMEs.

While securitisation will indeed free up bank balance sheets, it will not necessarily translate into additional loans, especially if the lack of loan growth comes from a lack of demand. It should also be noted that European banks have taken steps to clean up their balance sheets and increase their capital and are now in a better position to lend to the real economy.

Additionally, Finance Watch argues together with other stakeholders that the securitisation of SME loans will be too complex and too expensive to work without subsidies, due to the need to remunerate a number of intermediaries and to offer an attractive return to investors.[4] We therefore question the idea that securitisation can be a sustainable financing alternative for SMEs.

d. Assumption 4: We need to increase retail savings in Europe and channel them away from bank deposits and towards capital markets.

We are not convinced that additional retail savings should be incentivised for the purpose of reviving growth. Not only are European savings ratios relatively high and stable, but there is also already plenty of private financial capital looking for investment opportunities, with total assets under management in the European asset management industry close to €16,000 billion in 2013.[5]

What is needed right now for the purpose of growth and job creation is more consumption, not more savings.

We also query the Commission's suggestion that retail savings currently in bank deposits need to be "unlocked" and channelled to a more productive use in capital markets: retail deposits *do* finance the real economy and contribute to a stable banking system; pushing individual savings into capital markets might also create additional risks for retail investors.

e. Assumption 5: Much prudential regulation has been put in place since the crisis, we are now done with stability concerns and should focus on growth.

While much regulation has been put in place after the crisis, most of it is focused on making individual banks more robust but very little has been done to make the financial system as a whole more robust and stable. This is indeed a very different task: making the system more robust requires, among other things, ensuring that financial institutions do not run into trouble at the same time. If one medium-sized bank runs into trouble, this is not a threat to the financial system, as other banks can buy the troubled bank and ensure a continuity of services. If however most banks experience troubles simultaneously, as happened during the crisis, governments will need to intervene to bail them out with taxpayer money.

---

[3] Finance Watch 2014 http://www.finance-watch.org/our-work/publications/998-position-paper-on-ltf

[4] See Finance Watch 2014 p20

[5] FT Adviser, Hughes, E. A., *Half of managers have had no inflows for three years*, 2 October 2013 https://www.ftadviser.com/2013/10/02/investments/discretionary-management/half-of-managers-have-had-noinflows-for-three-years-w7vrYqzoNztsMbE86KyOsM/article.html

Preventing this from happening again would require, for example, ensuring that banks do not all invest in the same things and limiting the web of contracts between institutions to reduce the risk of domino effects. As long as this is not done, we have not sufficiently reduced the risk of future crises, which is a pre-requisite for sustainable growth.

Question 1: Beyond the five priority areas identified for short term action, what other areas should be prioritised?

We believe that three additional areas should be prioritised:
1. **The retail funded traditional and local banking model should be actively promoted** given its benefits: it has indeed proven to be robust, less procyclical and more focused on lending to the real economy than alternative models. Practically, promoting this model would entail redesigning the prudential liquidity ratios for banks that currently implicitly favour liquid assets over stable funding and securities over loans. It would also mean removing the inbuilt advantage of the internal ratings based (IRB) approach over the standardised one that unduly favour large banks over small ones, and benchmarking effectively internal bank models to reduce discrepancies between banks.

2. **The negative externalities of securities financing transactions should be addressed** to reduce systemic risks (notably interconnectedness and the procyclicality of leverage creation) and incentivise more stable funding structures for banks. The Regulation on Securities Financing Transactions (SFT) as proposed by the Commission is not sufficient, as it merely improves transparency on these transactions. As described in the green paper "*although capital markets in the EU became more integrated prior to the crisis in terms of cross-border holdings of financial instruments, the crisis revealed that part of this integration was driven by debt-based wholesale banking flows which were prone to sudden reversals in the face of shocks*." **As the growth of non-bank lending will go hand in hand with a more collateral intensive financial system, this is a pressing issue to address**.

3. **Increase the use of macro prudential tools in prudential regulation** by tying in financial institutions' contribution to systemic risk and capital requirements. Systemic risk factors including the procyclicality of leverage, interconnectedness, the correlation between institutions' balance sheets and the stability of funding structures should be integrated into prudential regulation in order to comprehensively address systemic risks.

Question 2: What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?

Assessing the creditworthiness of an SME requires not only reading its financial statements but also crucially integrating qualitative elements such as knowledge about the local economic context and competition and the quality of its management. A bank with a local branch is very well placed to get this information, a faraway investor is not.

As these qualitative elements cannot be adequately integrated into quantitative credit scoring methodologies, we question the idea that non-local investors can perform the necessary due diligence to lend to SMEs.[6]

Therefore while standardising information is good in principle, we must ensure that it does not lead to loss of information, increased reliance on external risk assessments and the related risks of conflicts of interest, less informed investment decisions and more procyclical lending that withdraws in times of stress. **More availability of funding would not be truly beneficial to SMEs if this funding is not stable and acyclical**.

Question 5: What further measures could help to increase access to funding and channelling of funds to those who need them?

The crisis showed that access to funding is an issue mostly in times of stress. Therefore **rather than measures aimed at increasing access to funding in general, we need instead measures to reduce the procyclicality of lending and promote stable funding, and not just any funding**. This could be done by promoting as a priority less cyclical financing channels and channels that link borrowers and lenders more directly. This would reduce the risk that companies and households find themselves struggling for funding at the same time and also reduce the risk of credit bubbles.

We need to promote financing channels where lending decisions are based on the investors' expertise over time rather than on external risk assessments or quantitative metrics, where the intermediation chain is short and the process involves as little as possible credit, liquidity and maturity transformation, and stop systematically promoting liquid tradable securities over less liquid assets such as loans.

In this respect retail funded traditional local banking and fundamental investing (including venture capital) are very useful channels. Consistent with the long term initiative, patient capital investing in non-transformed illiquid assets should also be encouraged.
Securitisation however - even simple and transparent - is more procyclical, involves more transformation, more reliance on external risk assessments and longer credit intermediation chains than traditional banking or basic bond and equity markets.
Securities financing transactions such as repo are also a very cyclical form of financing leading to unstable bank funding structures that should not be encouraged in our view.
Answering this question might thus in our view entail reassessing some of the priorities identified.

[6] With the exception of investors such as venture capital funds that truly assess the potential and value creation of the companies they invest in. On the contrary, investors investing in large pools of SME loans will typically not have the resources to assess each company individually.

Question 7: Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environment, Social and Governance) investment, including green bonds, other than supporting the development of guidelines by the market?

The EU should take action to strengthen the robustness of the green bond principles in order to ensure their effectiveness and credibility. This is key to generate investors' confidence and facilitate the development of this market. EU action is all the more necessary since some recent green bond issuances have proven to be controversial,[7] as have some criteria,[8] and it is essential to ensure that the label is not perceived as greenwashing.

Question 10: What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

It is not clear in our view that policy measures are needed to incentivise institutional investors to raise and invest larger amounts in long term projects such as infrastructure and SME loans in general, as they are already increasing their asset allocation to alternative asset classes in response to the very low interest rates environment.
As stated in our recent position paper[9], the currently low levels of institutional investors' asset allocation to infrastructure might hide the fact that infrastructure is already a booming area with growing amounts of capital being earmarked for this "new asset class": institutional investors increased their input into European infrastructure by 465% between 2010 and 2013 compared with the previous four years.[10]
A recent survey found that private equity "dry powder", the money raised from investors for investments in infrastructure, real estate, venture capital and credit and not yet invested, stood at a record $1.07 trillion a year ago.[11] It was also found that investors continually do not meet their target allocations for infrastructure,[12] as too much money is chasing too few assets.
Industry stakeholders acknowledge that "*every pension plan on earth is focusing on these assets*"[13] and that "*the amount of capital chasing the sector has never been greater and the competition has never been fiercer*".[14] "*There is no fundamental scarcity of private*

[7] "*"Green Bond" Issue Risks Raising Finance for Destructive Dams*" International rivers 2014 http://www.internationalrivers.org/blogs/258-0
[8] *"Trusting in Dark (Carbon) Markets?"* THE UN HIGH-LEVEL ADVISORY GROUP ON CLIMATE FINANCE http://www.iatp.org/files/451_2_107713.pdf
"Climate Bonds standard risks enshrining biofuel fallacy" Global capital 2015 http://www.globalcapital.com/article/qr106xnbs8pt/climate-bonds-standard-risks-enshrining-biofuel-fallacy
[9] Finance Watch 2014 "A missed opportunity to revive boring finance?" http://www.finance-watch.org/press/press-releases/995-fw-position-paper-on-ltf-securitisation-and-securities-financing
[10] Linklaters, *Set to revive: Investing in Europe's infrastructure*, Full Report, 10 March 2014
[11] Preqin press release, *Private Equity Industry Ends 2013 with Record $1.074 trillion of Dry Powder*, 19 December 2013
[12] World Economic Forum, Wyman, O., *Infrastructure Investment Policy Blueprint*, February 2014
[13] Financial Times, Liinanki, C., *Danish pension fund changes to infrastructure*, 23 February 2014
[14] Financial News, Russell-Walling, E., *Infrastructure goes down the capital markets road*, Issue 882, 13 January 2014

capital”,[15] in fact “*it is not a lack of private finance that is the obstacle to a revival in European infrastructure, but the lack of assets to buy, or appropriately structured projects to invest in*” according to recent analyses.[16]

Additionally, it must be emphasised that **a further involvement of institutional investors is only desirable to the extent that they use their long term liabilities to invest long term and play the stabilising counter-cyclical role expected of them**, by buying assets when their price declines instead of herding together with the rest of the market and instead of engaging in reverse maturity transformation. As discussed in a recent paper by Andrew Haldane[17] “*in fact, the evidence suggests quite the opposite happened*” with institutional investors ducking for cover during the crisis and in the process amplifying the market cycles. “*Patient capital ought to be part of the solution to the long-term financing puzzle. In practice, it may have been part of the problem*.”

Lastly we must ensure that **transferring risk from banks to institutional investors like pension funds does not create additional moral hazard**: if tomorrow a large pension fund runs into trouble, it is quite likely that there will be a political willingness to bail it out.

Question 12: Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets? If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?

We understand the political case for tailoring the treatment of infrastructure investments that have clearly identified positive externalities, where they are viable economically but there is a structural lack of investor appetite. Such a tailored treatment should also incentivise long holding periods over tradability and liquidity.

However, as the example of sovereign debt zero weighting shows, adjusting risk weights to provide politically motivated incentives can be detrimental to financial stability. The subprime crisis is another recent example of well-meaning but ultimately misguided political incentives to increase home ownership.

Question 16: Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

We believe that “safely” is the key word in the question and understand it to mean "in a sustainable manner". For us sustainable lending means among other things that:
a. An increase in bank and non-bank direct lending should not lead to excess lending in good times and a sudden withdrawal of funding in times of stress.

[15] World Economic Forum 2014
[16] EIB, Engel, E. M. R. A., Fischer, D. and Galetovic, A., *The economics of infrastructure finance: Public-private partnerships versus public provision*, 2010. Also see Linklaters 2014 and World Economic Forum 2014
[17] Haldane, A. G., *The age of asset management?,* 2014

b. Lending decisions should be based on sound risk assessments and due diligence performed by the lender itself on the basis of adequate information and via simple structures and products.

On direct bank lending, as European banks are recapitalised and are in the process of cleaning their balance sheets, they are able to lend more to companies that need finance. In order for this lending to be safe, four potential impediments need to be addressed:
a. The funding structure of large European banks relies excessively on wholesale funding, which represented 61% of their liabilities in 2012, twice more than in the US (31%), in Asia (33%) or in emerging economies (37%).[18] This creates fragile funding structures that can get in the way of providing stable lending to the real economy. It has also been argued that the growth of non-core liabilities is a sign of excessive lending in a boom.[19]
b. Banks should not be allowed to operate with excessive leverage. In this respect the future leverage cap should be both sensible and include a countercyclical element, as we argued in our policy paper on CRD IV.[20]
c. The securitisation of bank loans has in the past proven to lead to more market driven lending decisions, additional procyclicality and interconnectedness. It is essential that only the most basic structures with the shortest intermediation chains and the least transformation be promoted.
d. Lastly bank prudential liquidity ratios should be redesigned to favour stable funding over liquid assets: they currently offer banks the choice between having more liquid assets or more stable funding (longer than 12 months); banks tend to prefer the former with the consequence that securities can crowd out loans.

Safely increasing non-bank lending to companies would require favouring as a priority financing channels where:
a. lending decisions are based on expert risk assessments of the creditworthiness of the borrowers performed by the lender itself rather than relying on external assessments and due diligence and relying on collateral,
b. intermediation chains are the shortest and assets are the least transformed with regards to their credit, liquidity and maturity,
c. the procyclicality of leverage is the lowest,
d. investors have the ability and willingness to invest over a long horizon.

In practice, this means for example that capital market channels such as plain vanilla bond markets, equity markets, venture capital or covered bonds should be favoured over channels such as securitisation.

---

[18] Le Leslé, V., Bank Debt in Europe: *"Are Funding Models Broken?"*, WP/12/299, December 2012c http://www.imf.org/external/pubs/ft/wp/2012/wp12299.pdf

[19] Song Shin, H., *Policy Memo Macroprudential Policies Beyond Basel III*, Princeton University, 22 November 2010

[20] "*Our proposal for a leverage ratio is based on the double conviction that it must be calculated using IFRS accounting standards if policy makers want to start addressing the issue of the interconnectedness of the banking sector, and that a flexible ratio fixed at 5% / 20x leverage for normal times (and consistent with a Tier 1 capital ratio equal to 10% of risk weighted assets) and at 3% / 33.3x leverage in downturns gives the countercyclical flexibility necessary to adapt the banking landscape to economic cycles*." See p20 http://www.finance-watch.org/press/press-releases/505

Question 18: How can the ESAs further contribute to ensuring consumer and investor protection?

The ESAs have an essential role to play to ensure consumer and investor protection and this role might be growing if and when retail savings are channelled to a greater extent to capital markets and via a greater use of new technology.
We strongly support the good work done by the ESAs on PRIIPs Level 2 and in particular the idea to develop some guidance on the criteria for the comprehension alert.[21] We believe that such a tool if well designed can significantly improve retail investor protection: it would address design flaws in structured products and be complementary to other measures addressing issues at the point of sale.

Question 19: What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

The question is based on the assumption that households savings held in bank accounts should be channelled to a more productive use into capital markets. It is however not clear in our view that shifting retail savings from bank deposits to capital markets would contribute to creating sustainable growth: retail savings held in bank deposits do finance the real economy as they provide stable funding for banks that in turn provide loans to non-financial corporations and households.
Shifting savings to capital markets would lead to more bank reliance on wholesale funding, more fragile bank funding structures and a higher cost of funding for banks. It might also increase the risk of mis-selling whereas it is not clear that it will contribute to higher risk-adjusted returns on average for retail investors.

The impact of promoting online trading platforms for retail investors is also unclear: the growing institutionalisation of retail savings means that the bulk of retail investments in capital markets is done via fund managers rather than through direct investment.
Additionally, while the development of online trading might lead to a welcome decline in transaction costs, past experiences also suggest that supervisors need to prevent providers from offering significant leverage to retail investors to avoid excessive losses.[22]

Question 20: Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

The French warning label developed by the AMF has proven to be very effective in curbing the inclusion in retail financial products of features known to be detrimental to retail investors, either because the product invests in exotic asset classes, or when the return is based on a complex formula.

---

[21] http://www.finance-watch.org/our-work/publications/1030-fw-response-esas-discussion-paper-priips-level-2-en
[22] http://www.amf.eu/en_US/Actualites/Communiques-de-presse/AMF/annee_2014.html?docId=workspace%3A%2F%2FSpacesStore%2F96c52a14-3900-464f-8fff-7d4700ff37e3

As described in our policy paper "*Product rules for packaged retail products: why, when, how?*" [23] other national approaches such as Belgium's FSMA voluntary moratorium on the distribution of complex products are also very useful to protect retail investors.

Limiting the offer of leverage to retail investors would also be a very useful measure.

Question 21: Are there additional actions in the field of financial services regulation that could be taken ensure that the EU is internationally competitive and an attractive place in which to invest?

Some stakeholders fear that introducing a tight framework for high quality securitisation might create competitiveness concerns vis-à-vis the US. We believe on the contrary that the commercial success of the UCITS framework is strong evidence that investors value a sound and tight framework, and that soundness and commercial success go hand in hand.
Also, as it is also acknowledged that investors' negative perception of securitisation is one of the main impediments to its revival, a tight securitisation framework would help to restore investors' confidence. In this respect the future definition of qualifying securitisation should go further than the definitions currently put forward and be truly simple by excluding tranching.

Question 23: Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

As a general comment the idea that we need to promote increased market liquidity is a double-edged sword in our view: while it will help the functioning of the market in normal times, market liquidity is procyclical, being highly dependent on investors' greed and fear, and can decline very quickly in times of stress. This is problematic given financial markets' well known manic-depressive behaviour and their tendency to overreact irrationally from time to time. The current excessive focus on liquidity and tradability not only encourages the excessively short term approach of investors but also contributes to a highly procyclical and interconnected financial system. **Increasing market liquidity would therefore call for a parallel development of robust private backstops and measures to incentivise and reward countercyclical behaviour**.

Additionally and consistent with the objective to promote long term investment, we believe that the European Commission should truly promote patient capital investing in illiquid assets for the long term.

[23] http://www.finance-watch.org/our-work/publications/627

Question 27: What measures could be taken to improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?

Improving the cross-border flow of collateral is also a double-edged sword as evidenced during the crisis.
First by unifying the legal framework for the cross-border use of collateral in 2002, the ECB designed a framework that treated all Eurozone sovereign debt as equal collateral. The purpose was to "*create a de facto fiscal union, where financial institutions would provide market liquidity to all sovereigns, thus eroding differences in funding costs*" and "*enable national banking champions to become global players, competing successfully with US financial institutions*".[24] This worked in normal times as the "*yield differentials between Eurozone sovereigns narrowed substantially*". However when the crisis hit, investors started to be concerned about some Member States and yields started diverging massively and quickly, creating fragmentation and shattering the idea of sovereign debt as the ultimate safe asset. **An integration via capital markets might therefore not be as stable and sustainable as would be desirable**.

Additionally, **the growing role of collateral** as a lubricant of financial transactions following the Financial Collateral Directive had another detrimental impact: it **led to additional procyclicality and interconnectedness in our financial system, creating downward price spirals and funding stresses in bad times.**
When markets go up and risk appetite is high, investors are willing to accept more assets as collateral, are willing to accept as well lower haircuts, and the market value of the collateral also increases while its volatility declines, enabling banks to obtain more and more funding against a given asset in good times. Symmetrically, when markets turn and investors start to be concerned, the opposite process takes place, investors start refusing assets of lower quality as collateral, they also start requesting higher haircuts, and the marked-to-market values of collateral assets decline, triggering a credit crunch and asset fire sales that fuel in turn the vicious cycle of declines in asset prices and contaminating other institutions. Haircuts, fluctuating pools of eligible collateral, collateral velocity and the marking to market of collateral assets are responsible for the additional procyclicality and interconnectedness of the financial system.

In order for an improved cross-border flow of collateral not to create additional risks, we need to address these issues: first general collateral must be truly safe this time and less vulnerable to investor confidence evaporating quickly.
Secondly several proposals have been put forward to reduce the procyclicality and interconnectedness of collateral such as introducing minimum haircut floors, capping the re-use of collateral and linking deposit guarantee schemes premiums to the use of securities financing.
More generally, **while collateralised funding can be extremely useful at times of stress when trust disappears, it would be unhealthy in our view to strengthen its central role in our financial system and make it the new norm**.

---

[24] Gabor, D., *Banking union: a response to Europe's fragile financial integration dreams?,* UWE Bristol, Economic Policy Brief No. 3, April 2014a

Question 30: What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

We strongly support the European Commission's proposal to address differences in the tax treatment of debt and equity financing.
We fully agree with the assessment that the preferential treatment of debt creates detrimental distortions and incentivises leverage. We also agree that differences across Member States in the tax treatment of debt and equity may create opportunities for profit shifting that should be addressed.
Moving forward to address the different tax treatment of debt and equity financing should be one of the priorities. As an added benefit it would also address some of the issues currently identified within the resolution framework: it would incentivise banks to issue truly loss-absorbing equity instead of bail-inable debt subject to disruptive repricing and uncertainty.

Question 32: Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

Achieving a stable Capital Markets Union requires truly promoting the diversity of business models and financing channels.
It also requires **rewarding countercyclical behaviours and promoting robust private backstops**, something that is not currently incentivised. **This is essential in a context of growth of non-bank lending if we want to truly reduce moral hazard and the future use of implicit and indirect access to public safety nets.**

It requires as well crucially **curbing the procyclicality of leverage and interconnectedness**, in order to provide the kind of stable financing and environment that benefits companies and EU competitiveness. In this respect legislative action is required to address these issues.[25] The European Commission should among other things build on the Financial Stability Board's regulatory framework for haircuts on non-centrally cleared securities financing transactions and go beyond the currently negotiated Directive on transparency of securities financing transactions to cap the re-use of collateral and introduce minimum haircuts for all securities financing transactions.

[25] See Finance Watch position paper pages 35-39, 46-47 and 77-80 *"A missed opportunity to revive "boring finance"?"* http://www.finance-watch.org/our-work/publications/998-position-paper-on-ltf