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COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on Long-Term Financing of the European Economy

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1. INTRODUCTION

1.1 Economic context

The economic and financial crisis has affected the ability of the financial sector to channel funds to the real economy, in particular to long-term investment. Heavy dependence on bank intermediation, combined with bank deleveraging and reduced investor confidence, has reduced funding to all sectors of the economy. The Union has acted with determination to reverse these trends and restore the conditions for sustainable growth and investment. Public finances have been consolidated and procedures for better coordination of budgetary and economic policies have been put in place. The ECB has acted firmly to restore confidence in the markets, and the establishment of the Banking Union is helping to reduce financial fragmentation and restore trust in the Euro area.

Harnessing these improvements requires long term investment which can underpin smart, sustainable and inclusive growth. The ability of the financial system to channel funds to long-term investments will be essential in securing Europe's position on a sustainable growth path.

1.2 The need for long-term financing

Long-term financing embodies some key features[1]:

- It finances *productive* activities which support growth by reducing costs, diversifying means of production and creating jobs in a smart, sustainable and inclusive way;
- It is *patient*, in that investors take into account the long-term performance and risks of their investments, rather than short-term price fluctuations. This long-term perspective acts in a counter-cyclical manner and promotes financial stability;
- It is *engaged*, in that investors take longer-term aspects such as environmental, social, governance issues into account in their investment strategies.

Infrastructure and SMEs are key contributors to sustainable growth. High quality infrastructure improves the productivity of the rest of the economy, enabling growth, and facilitates the interconnection of the internal market. Investment needs for transport, energy and telecom infrastructure networks of EU importance are estimated at EUR 1 trillion for the period up to 2020[2]. Significant investment will also be needed in human capital[3] and in R&D, new technologies and innovation under the Europe 2020 strategy and the 2030 climate and energy package[4].

SMEs represent around two thirds of the employment and nearly 60% of the value added in the EU. They contribute significantly to GDP growth through their overall importance as well as their ability to innovate, grow and create employment.

The climate of uncertainty and risk aversion created by the financial and economic crisis has affected both the demand and the supply of financing. On the demand side, this has been evidenced by reduced demand from SMEs, Private Public Partnerships and other investment projects requiring long-term financing, resulting in a suboptimal level of long-term investment and financing. On the supply side, the crisis has increased risk aversion, leading

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[1] Terms introduced by the OECD in "Promoting Longer-Term Investment by Institutional Investors: Selected Issues and Policies", 2011, http://www.oecd.org/daf/fin/private-pensions/48616812.pdf.

[2] Connecting Europe Facility: c.EUR500bn in transport, EUR200bn in energy and EUR270bn in fast broadband (http://ec.europa.eu/transport/themes/infrastructure/connecting/doc/connecting/2012-10-02-cef-brochure.pdf).

[3] See Social Investment Package, COM (2013)83 of 20.2.2013.

[4] Communication on a policy framework for climate and energy in the period from 2020 to 2030, http://ec.europa.eu/energy/doc/2030/com_2014_15_en.pdf.

to a preference for liquidity which, together with bank deleveraging, has affected the economy's ability to finance itself at long maturities. The sub-optimal levels of long-term financing also reflect market failures and inefficiencies in the intermediation chain[5].

Addressing these issues is a priority for Europe. The capacity of the economy to make long-term financing available, reinforcing the competitiveness of Europe's economy and industry, depends on its ability to channel savings through an open, safe and competitive financial sector. To this end, legal certainty and investor confidence are essential.

1.3 Green Paper and public consultation on long-term financing

The European Commission adopted on 25 March 2013 a Green Paper on long-term financing, which initiated a broad debate on the different factors that drive the ability of the European economy to attract the funds it needs to sustain and accelerate its recovery. The paper aimed to explore how the savings of governments, corporates and households could be better channelled to long term financing needs.

The Green Paper consultation was very positively received by stakeholders and elicited 292 responses from all segments of the economy[6]. A large majority of stakeholders agreed with the need to broaden the sources of long-term financing in Europe, while recognising the important role that banks will continue to play, particularly for SMEs. While a well-defined and stable regulatory environment was underlined as very important, many stakeholders also called for better calibration of regulatory reform to take account of long-term financing objectives.

1.4 Other European and international policy initiatives

The debate on long-term financing has been echoed at European and international level. The Economic and Financial Committee set up a High Level Expert Group, which published its report in December 2013[7], focused on SMEs and infrastructure. The European Parliament adopted on 26 February 2014 a resolution[8] on the long-term financing of the European economy. The resolution includes many of the issues covered by this Communication.

At the international level, the G20 endorsed in September 2013 a work plan on financing for investment[9] and established a working group to carry out further work on long-term finance. The OECD has developed high-level principles for institutional investors when engaging in long-term financing[10].

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Against this background and building on the Green Paper consultation, this Communication presents a set of concrete actions. Developing and diversifying how long-term investment is financed is a complex and multidimensional task, with no single action or "magic bullet", but a range of responses and initiatives. The actions proposed in this Communication focus on (i) mobilising private sources of long-term financing, (ii) making better use of public finance, (iii) developing capital markets, (iv) improving SMEs' access to financing, (v) attracting private finance to infrastructure, and (vi) enhancing the overall environment for sustainable finance.

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[5] For a detailed explanation see the Commission Staff Working document accompanying the Green Paper on long term financing: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=SWD:2013:0076:FIN:EN:PDF.
[6] A detailed summary of responses as well as the non-confidential responses can be found at http://ec.europa.eu/internal_market/consultations/2013/long-term-financing/docs/summary-of-responses_en.pdf.
[7] http://europa.eu/efc/working_groups/hleg_report_2013.pdf.
[8] http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?reference=2013/2175(INI)&l=en.
[9] See http://en.g20russia.ru/news/20130906/782782178.html.
[10] See http://www.oecd.org/finance/private-pensions/G20-OECD-Principles-LTI-Financing.pdf.

The Commission is also presenting today, together with this Communication:

- A proposal to revise the Institutions for Occupational Retirement Provisions (IORP) Directive to support the further development of occupational pensions, an important type of long-term institutional investor in the EU;
- A Communication on crowdfunding, a growing source of financing for SMEs.

2. MOBILISING PRIVATE SOURCES OF LONG TERM FINANCING

The support of responsible bank lending and the fostering of non-bank sources of financing, such as institutional investors, including insurance companies, pension funds, traditional or alternative investments funds, sovereign funds or foundations is crucial: while banks will continue to play a significant role, the diversification of funding is important in the short run to improve the availability of financing, as well as in the long run, to help the European economy sustain future crises better.

Banks

Under the Capital Requirements Regulation (CRR) and the Capital Requirements Directive IV (CRD IV)[11] being phased in from January 2014, banks are required to hold higher levels of capital, increasing their ability to absorb potential losses. An assessment of the appropriateness of the CRR requirements for long-term financing will be made by the Commission in two stages, in 2014 and 2015.

Banks will also be subject to new liquidity management requirements to enable them to absorb sudden liquidity shocks. While this should engender more confidence in the financial system, it is argued that tightened liquidity rules may impact banks' ability to lend at long maturities. The implementation of the Liquidity Coverage Ratio (LCR, a liquidity ratio with a one-month horizon) in Europe and the current international discussions on the definition of the Net Stable Funding Ratio (NSFR, a liquidity ratio with a one-year horizon) must find the right balance between improving the resilience of the banking sector to liquidity shocks and avoiding excessive restrictions on maturity transformation that discourage long-term financing.[12] Furthermore, the CRR provides for the phased-in implementation of the LCR and introduces a long observation period before any legislative proposal on the NSFR.

The banking reforms and in particular the Banking Union are crucial to restoring confidence in the financial sector and reducing the current market fragmentation, which affects particularly the financing of SMEs. Once these reforms are completed, borrowers and investors should benefit from a larger, deeper and better regulated and supervised market.

The recent European banking structural reform proposal[13] is also important, as it aims at safeguarding core financial activities, such as lending to the economy, by separating these from risky trading activities. This would also curb the current cross-subsidisation of trading activities by deposits, thus increasing the incentives for banks to lend to the real economy.

Actions

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[11] Regulation 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation 648/2012 and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investments firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC.

[12] Cf. Recital 100 of Regulation 575/2013.

[13] COM/2014/043.

- The Commission will prepare reports on the appropriateness of the CRR requirements relating to long-term financing by 2014[14] and 2015[15].
- The Commission will take the fullest account, in the preparation of the Delegated Act on LCR[16] (expected in the first half of 2014) and the final calibration of the NSFR[17], of the need not to unduly restrict long term financing by banks. In addition, full advantage should be taken of the monitoring period in the CRR to adjust and address potential unintended consequences of the new liquidity rules for long-term investment.

Insurance companies

Institutional investors such as insurance companies are suitable providers of long-term funding. While investment by institutional investors in less liquid assets such as infrastructure assets has been limited, the search for higher yields in a low interest rate environment is increasing their appetite for such assets.

Solvency II[18], applicable from 1 January 2016, will repeal certain investment obstacles, particularly for less liquid asset classes, which currently exist in Member States. Insurers will be free to invest in any type of asset subject to the prudent person principle, whereby they should be able to "properly identify, measure, monitor, manage, control and report"[19] the risks associated with such assets.

It is argued that strengthening capital requirements to capture all quantifiable risks, including market risk (which was not considered in the previous legal regime, Solvency I) may influence the investment behaviour and long-term outlook of insurers as institutional investors.[20] For this reason, the Commission asked the European Insurance and Occupational Pensions Authority (EIOPA) in September 2012 to examine whether the calibration and design of capital requirements necessitates any adjustment, without jeopardising the prudential effectiveness of the regime, particularly for investments in infrastructure, SMEs and social businesses (including securitisation of debt serving these purposes). EIOPA's analysis was provided in December 2013.[21] It recommends criteria to define high-quality securitisation and designs a more favourable treatment for such instruments, by lowering the corresponding stress factors.[22] This is a major step in the wider agenda of fostering

[14] Article 505: The Commission shall report by 31 December 2014 to the European Parliament and the Council about "the appropriateness of the requirements of this Regulation in light of the need to ensure adequate levels of funding for all forms of long-term financing for the economy, including critical infrastructure projects in the Union in the field of transport, energy and communications".

[15] Article 516: The Commission shall report by 31 December 2015 on the impact of this Regulation on the encouragement of long-term investments in growth promoting infrastructure.

[16] Article 460 of the CRR.

[17] Article 510(3) of the CRR.

[18] Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

[19] Article 132 of Solvency II.

[20] Capital requirements are only one driver of investment decision, alongside tax regimes, accounting rules or lack of insurers' expertise in less liquid assets.

[21] See https://eiopa.europa.eu/fileadmin/tx_dam/files/consultations/consultationpapers/EIOPA-13-163/2013-12-19_LTI_Report.pdf.

[22] Unlike in the banking sector, capital requirements depend on each insurer's risk-profile and are much lower than the stress factors because the calculation is not purely factor-based. Capital requirements correspond to insurers' potential loss in stressed market conditions, after taking into account a number of mitigating factors specific to each insurer (reduction of future bonuses to policyholders, deferred tax credits, hedging, diversification with other sources of risk, etc.). Based on the most recent Europe-wide quantitative impact studies, the Commission estimates that capital requirements for market risk in a typical life insurer with long-term liabilities are between two and three times lower than the stress factors for each type of investment.

sustainable securitisation markets (*see Section 4 on securitisation*). The Commission will take the latest EIOPA report into account when formulating the relevant Delegated Acts for Solvency II, including possible adjustments to the treatment of assets classes other than securitisation (infrastructure, SMEs and social businesses), as set out in the original mandate to EIOPA.

Furthermore, the Omnibus II directive[23] will introduce measures into Solvency II which are specifically designed to reinforce existing incentives to match long-term liabilities with long-term assets and to hold these to maturity. The list of assets eligible for the use of the matching adjustment has been broadened to include key long-term investments such as infrastructure project bonds.

Actions

- The Commission intends to adopt at the latest in September 2014 the Delegated Act for Solvency II, including a number of incentives to stimulate long-term investment by insurers.

Pension funds

Pension funds are institutional investors with long-term liabilities. As such, they have the capacity to be "patient" investors. The Commission welcomes that pension funds are increasingly turning to alternative investments such as private equity and infrastructure to diversify portfolios and provide higher returns[24]. The IORP 2 proposal adopted today could contribute to more long-term investment by occupational pension funds by limiting the possibilities for Member States to restrict certain types of long-term investment.

Besides occupational pension funds, personal pension products also have the potential to foster long-term investment. In November 2012, the Commission invited EIOPA to prepare technical advice on the development of an EU-wide framework for the activities and supervision of personal pension products[25]. This would represent an opportunity to mobilise more savings for financing long-term investment, thereby fostering both retirement income adequacy and economic growth. EIOPA was asked to consider at least two approaches: (i) develop common rules to enable cross-border activity of personal pension schemes; or (ii) develop a 29th regime whereby EU rules do not replace national rules, but are an alternative to them. EIOPA has delivered a preliminary report on personal pension products in February 2014.

Actions

- The Commission services will issue a comprehensive Call for Advice to EIOPA in the second half of 2014 with the objective of creating a single market for personal pensions and thus potentially mobilising more personal pension savings for long-term financing.

Private savings accounts

The Green Paper received some stakeholder support for exploring ways to increase cross-border flows of savings, including through the introduction of an EU savings account aimed

[23] A directive proposed in 2011 (COM 2011/0008) to adapt Solvency II to the new framework for implementing measures introduced by the Lisbon Treaty and to the creation of EIOPA.

[24] However, the proportion of their assets allocated to such investments remains limited, particularly for infrastructure assets. For example, a recent OECD survey of 86 large pension funds and public pension reserve funds (http://www.oecd.org/daf/fin/private-pensions/survey-large-pension-funds.htm) found that only 1% of their assets were invested in unlisted infrastructure investments and 12-15% were invested in other alternative investments (the rest of the assets were invested in fixed income, cash and listed equity).

[25] http://ec.europa.eu/internal_market/pensions/docs/calls/072012_call_en.pdf.

at offering a standardised framework to encourage savers to contribute to long-term financing. Such an exercise would first look at national models and consider aspects such as remuneration rates, national deposit protection, complementarity with existing national schemes, fund collection and criteria for lending.

Actions

- The Commission services will undertake by the end of 2014 a study of possible market failures and other shortcomings regarding cross-border flows of savings, including an overview of national savings account models and an assessment of the opportunity of introducing an EU savings account.

3. MAKING BETTER USE OF PUBLIC FUNDING

The public sector is a key contributor to gross capital formation in the form of tangible and intangible investment. Efforts are needed to ensure more transparent and efficient use of public funds, to maximise the return on public investment, its contribution to growth and its ability to leverage private investment. The Commission will continue to monitor the fiscal policies of the EU-28, including the quality of public expenditure and compliance with the Excessive Deficit Procedure through the EU Semester. In addition, a wide focus, which addresses also the activity of national promotional banks and export credit agencies, is needed.

National Promotional Banks (NPBs)

National and regional Promotional Banks play an important role in catalysing long-term finance along with the EIB/EIF and other Multilateral Development Banks (MDBs) like the EBRD. In recent years they have stepped up their activities, aiming to counterbalance the shrinking balance sheets of commercial lenders. Given the stabilising economic situation and the limited lending capacity of these institutions, there is a need to focus on market failures and on value added operations. During the consultation, calls were made for more joint EU-national or multinational initiatives and for simplified procedures with regard to promoting cooperation and synergies between the EU budget and the EIB/EIF, MDBs and NPBs, and with regard to an enhanced involvement of NPBs in EU policies and access to EU funds. The policies include environmental, climate externalities, innovation, and social and human capital development. In addition, the issue of coordination between multilateral banks and NPBs was considered important in order to optimise synergies and complementarities and to avoid overlapping of efforts and funding duplication.

Actions

- The Commission will issue in 2014 a Communication regarding promotional banks to provide guidance on general principles; governance and transparency, as key drivers to ensure investor confidence and favourable funding conditions; supervision and regulatory aspects; and the role of NPBs in co-investing and delivering EU budget funds to support European policy priorities for 2020 and beyond.
- The Commission will encourage and monitor the cooperation of NPBs with the EIB/EIF and possibly other MDBs as requested by the June 2013 European Council and report to the December 2014 Council.

Export Credit Agencies

Export credit agencies are both investors and guarantors/underwriters of risk for long term financing. As such, they could play an important role in supporting cross-border investment within the EU, as well as supporting exports of capital goods outside the EU. This is an area where tensions regarding sovereign risk have an immediate impact on long term financing, notably in the case of long-term guarantees.

Actions

- The Commission services will publish a report on promoting better coordination and cooperation among existing national credit export schemes.

4. DEVELOPING EUROPEAN CAPITAL MARKETS

Policy effort is needed in Europe to diversify financing channels. European capital markets are on average relatively underdeveloped and are currently insufficient to fill the funding gap created by bank deleveraging. Appropriate financial instruments are also required to allow financial markets to play an active and effective role in channelling funds into long term investment. This includes innovative financial instruments linked to the key challenges of sustainable growth in Europe, such as infrastructure, climate and social impact bonds (*see section 6*).

Equity and corporate bond markets

Capital market financing has suffered significantly since the crisis but the downward trend dates back to the 1990s. The numbers of Initial Public Offerings (IPOs) in Europe and the US are down roughly five times from their pre-1999 numbers[26]. Studies in the US also show that the time to IPO has doubled, from 4.8 years in the early 1980s to over 9 years since 2007[27]. Even taking into account the cyclical nature of IPOs, these trends are worrying particularly in terms of job creation since the same US studies show that 92% of growth in a company occurs post-IPO. The setting up of an IPO Task Force by several market associations[28] to address these issues is a welcomed initiative.

Corporate bond issuance is used by large, rated companies, with bonds issued in large denominations and purchased by financial institutions. This market has been growing in recent years. These instruments are however not typically available for SMEs/midcaps although in the past years several markets have also been created for retail bonds in Germany (BondM market launched in 2010), the UK (ORB launched in 2010), France (IBO launched in 2012) and Italy (ExtraMOT PRO launched in 2013).

Despite such national initiatives, European capital markets for both bonds and equities remain fragmented and not attractive enough for SMEs and mid-caps, with low levels of cross-border investment in securities other than blue chips. Important obstacles such as different securities and bankruptcy laws remain.

Actions

- The Commission delegated act provided for in MiFID 2[29] will ensure that the requirements for SME growth markets minimise the administrative burden for issuers on these markets, while maintaining high levels of investor protection. These requirements include the minimum proportion of SME issuers on these markets,

[26] IPOs for UK, Germany, France, Italy and Spain declined from c. 350 per year between 1996-2000 to c. 70 per year during 2008-2012 (see OECD Working Paper "Making Stock Markets Work to Support Economic Growth" http://www.oecd-ilibrary.org/governance/making-stock-markets-work-to-support-economic-growth_5k43m4p6ccs3-en). A similar decline was registered in the US, from c. 500 IPOs per year pre-1999 to c. 100 post-1999 (see http://www.sec.gov/info/smallbus/acsec/ipotaskforceslides.pdf).

[27] See http://www.sec.gov/info/smallbus/acsec/ipotaskforceslides.pdf.

[28] The Federation of European Securities Exchanges (FESE), EuropeanIssuers and the European Private Equity and Venture Capital Association (EVCA). See http://www.fese.eu/en/?inc=cat&id=8.

[29] According to Art. 35 of Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC (MiFID 2) as drafted in the final compromise text.

appropriate criteria for admission to trading, information to investors and financial reporting.

- The Commission services will undertake a study on whether, following the improvements introduced by MiFID 2 for non-equity securities, further measures are necessary to enable the creation of a liquid and transparent secondary market for the trading of corporate bonds in the EU.
- The Commission will assess the implications and effects of the rules of the Prospectus Directive by the end of 2015[30]. This will include in particular an assessment of the proportionate disclosure regime for SME issuers and companies with reduced market capitalisation.
- The Commission will explore whether the eligibility criteria for investments by Undertakings for Collective Investments in Transferable Securities (UCITS) could be extended to securities listed on SME growth markets that display certain liquidity characteristics, in view of the implementation of the MiFID 2 framework. The issue of whether the European Long-Term Investment Funds (ELTIFs) should also be able to invest in listed SMEs is a key issue currently debated in the context of the Commission's ELTIF proposal[31]. The Commission proposal already includes non-listed SMEs as part of the asset classes that would be eligible for an ELTIF investment.

Securitisation

Securitisation transactions enable banks to refinance loans by pooling assets and converting them into securities that are attractive to institutional investors. From a bank's perspective, such transactions unlock capital resources, increasing the ability of banks to expand their lending and finance economic growth. For institutional investors such securities, if of sufficient size, offer liquid investment opportunities in asset classes in which they do not invest directly, e.g. SMEs or mortgages.

Some securitisation models were inadequately regulated in the past. The weaknesses of these models have been identified early on and addressed in the subsequent EU financial reform. Risk retention ("skin-in-the-game") requirements have been in place in the EU banking sector since 2011 and have been widened to all financial sectors. In addition, disclosure obligations have been reinforced to allow investors to develop a thorough understanding of the instruments in which they invest.

Many concrete actions are being taken by the authorities to make securitisation transactions more standardised and transparent, thereby enhancing investors' confidence[32]. EU institutions and agencies need to increase their cooperation and develop synergies, for instance in terms of the standardisation of reporting templates. In addition initiatives led by industry such as the implementation of labelling contribute also to these objectives.

Despite these measures, no substantial recovery of this market has been observed so far. This is in large part due to the stigma still attached to these transactions and to their regulatory

[30] Article 4 of Directive 2010/73/EU of the European Parliament and of the Council of 24 November 2010 amending Directives 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

[31] See for example European Parliament Kratsa-Tsagaropoulou draft report on the proposal for a regulation of the European Parliament and of the Council on European Long-term Investment Funds.

[32] The main initiatives are the legal provisions in Credit Agencies Regulation requesting ESMA to establish a public website (CRA3, art. 8b) and the centralised European DataWarehouse (EDW) sponsored by the ECB.

treatment. Many stakeholders have called for a differentiation of securitisation products for prudential purposes in order to foster the development of sustainable securitisation markets. EIOPA's technical report for Solvency II and the Commission proposal on banking structural reform introduce a differentiation for "high" quality securitisation products.

Actions

- The Commission will work on the differentiation of "high" quality securitisation products with a view to ensuring coherence across financial sectors and exploring a possible preferential regulatory treatment compatible with prudential principles. The Commission will consider introducing this approach in relevant EU legislation across financial sectors. The Commission will notably take into account possible future increases in the liquidity of a number of securitisation products following further differentiation and standardisation.
- The Commission will work with the international standard setters, in particular the Basel Committee and the International Organisation of Securities Commissions (IOSCO), to develop and implement global standards especially on rules on risk retention, high quality standardisation and transparency to ensure consistency and avoid regulatory arbitrage.

Covered bonds

Covered bonds embody a standard means of tapping the capital markets for funding backed by good quality assets. While for investors these instruments provide safety and liquidity over senior unsecured securities, for issuers they provide benefits such as cost effective funding and funding diversification. Although various EU rules refer to Covered Bonds, there is currently no single, harmonised framework. Some Member States do not have specific legislation in place. Some convergence has nevertheless happened following the development of the eligibility criteria for preferential capital requirements in the banking sector into a widely accepted market standard[33].

Actions

- The Commission will review the covered bonds treatment in the CRR by the end of 2014[34] with a view to building the basis for an integrated European covered bond market. The review will consider credit quality, eligible collateral and transparency. It could also explore strengthening supervision, enforceability of preferential rights and bankruptcy segregation aspects.
- Taking into account the findings of the review described above, the Commission services will launch a study on the merits of introducing an EU framework for covered bonds.

Private placement

Private placements can offer an alternative to bank lending and public corporate bond issuance, potentially broadening the availability of finance for medium to large unlisted companies and potentially infrastructure projects. The current regulatory framework allows private placements and some Member States have already developed these markets (e.g. the "Schuldschein" market in Germany and "Euro PP" in France). There is growing supply and

[33] The provisions included in CRD from 2006 and now CRR has already led to an important harmonisation as regards the range of eligible assets for CBs. Also, as regards transparency, the CRR has also already set a minimum standard.

[34] See CRR article 503.

demand for this financing channel, as evidenced by the growth of the existing markets in the EU and by the number of European issuers accessing the US private placement market[35].

However, this activity has not picked up on a broader European scale. Reasons include lack of standardised documentation and information on the credit worthiness of issuers and lack of liquidity in the secondary market. Since information on recovery is particularly important for investors in these products, the differences in European insolvency laws have also been cited as barriers to the development of a wider cross-border private placement market.

Actions

- The Commission services will conduct by the end of 2014 a study to map out the private placement markets in Europe against other locations/practices, analyse their key success drivers and develop policy recommendations on how this success can be replicated more widely in the EU. Potential risks will also be assessed, since private placement markets are by definition less transparent than public capital markets and are highly illiquid. The study will build on the public consultation and the impact assessment carried out in 2007/2008[36].

5. IMPROVING SMEs ACCESS TO FINANCING

SMEs' particular dependence on bank funding has meant they suffered the most during the crisis. They are still finding it challenging to obtain loans, particularly in the periphery economies due in part to the fragmentation of the banking sector[37].

A key issue for SME finance is facilitating the transition from start-up to SME to mid-cap i.e. a transition across the so-called "funding escalator". As they progress through their life cycle, SMEs use a combination of financing sources including bank debt and external equity from business angels, venture capital, private equity funds and ultimately the capital markets. SMEs often find it challenging to transition from one mix of financing sources to another. Between different stages of growth, companies face "financing gaps" and "education gaps". This is particularly prevalent at the early stage and at the growth stage, due in part to limited venture capital funding in Europe.

In 2011 the Commission adopted an Action Plan on SME financing. Many of those actions have been implemented, including regulatory measures, financial programs and facilitation initiatives. An overview of the implementation of the Action Plan is provided in the Staff Working Document accompanying this Communication. Some of these actions are still ongoing, such as initiatives to address SMEs' education and information gaps through the Enterprise Europe Network. The future Network becoming operational in 2015[38] will provide more extensive advice and assistance to SMEs on accessing finance, and will cooperate closely with other local service providers such as financial intermediaries and accountants. Various coaching programmes have also been developed at national level, most

[35] In 2012, 36 European companies (of which 11 smaller companies, with revenues below $500m) used the US private placement market, for an amount of almost $20bn. See http://www.thecityuk.com/research/our-work/reports-list/alternative-finance-for-smes-and-mid-market-companies/.
[36] See http://ec.europa.eu/internal_market/investment/private_placement/index_en.htm.
[37] See the ECB Survey on the Access to Finance of SMEs in the Euro Area, April 2013 to September 2013 http://www.ecb.europa.eu/pub/pdf/other/accesstofinancesmallmediumsizedenterprises201311en.pdf?acff8de81a1d9e6fd0d9d3b38809a7a0. Only 33% of SMEs that apply for credit in Greece receive the full amount and only 50% do so in Spain and Italy (compared to a 65% average in the euro area and 87% in Germany) . However, some data is timidly improving: 60% of SMEs in Ireland report full success in obtaining a loan compared to 30% in the preceding six months, while in Spain this has also improved from 40% to 50%.
[38] See recent call for proposals by the Commission (http://ec.europa.eu/enterprise/contracts-grants/calls-for-proposals/index_en.htm).

notably to prepare SMEs to access capital markets (such as the ELITE programme developed by Borsa Italiana)[39].

A problem often cited as a hurdle that has traditionally made SMEs more dependent on local bank finance is the lack of adequate, comparable, reliable and readily available credit information on SMEs. The Commission organised a workshop in November 2013 with a wide range of stakeholders to discuss private and public national practices and new initiatives, with the aim of finding ways to improve SME information. The workshop confirmed that there are clear barriers to investors' and finance providers' access to reliable, available and comparable SME information across the EU. Such barriers are partly due to the vast differences between Member States on the degree of public information and its disclosure, mainly due to the design of the national legal frameworks.

Actions

- The Commission services will undertake in 2014 a mapping of the EU and national legislation and practices affecting the availability of SME credit information, with a view to considering possible EU approaches to the credit scoring industry and assessing the feasibility of harmonising/increasing the comparability of SME data across the EU.

- The Commission services will revive the dialogue between banks and SMEs with the aim of improving financial literacy of SMEs, particularly with regards to feedback provided by banks on loan applications. The Commission services will also assess best practices on helping SMEs to access capital markets.

6. ATTRACTING PRIVATE FINANCE TO INFRASTRUCTURE DELIVERING EUROPE 2020

Infrastructure investment was originally mostly geared towards large capital projects such as road and rail networks, energy pipelines and transmission grids and national telecom backbones. The new approach retained under Connecting Europe Facility (CEF) and European Structural and Investment Funds (ESIF) puts emphasis on sustainability, energy efficiency, innovation, interoperability and linkages in a multimodal European infrastructure. This means a shift to rail and intelligent traffic management in the transport sector, to low carbon power generation and energy efficiency in buildings and to interconnections in the energy and ICT sectors.

The EU Project Bond Initiative (PBI)[40] has been highlighted by many stakeholders as a positive example of attracting private capital to infrastructure projects; the Commission services are assessing a number of improvements to the PBI and the possible extension of project bond solutions to other infrastructure sectors, including sustainable transport, renewable generation and smart grid assets. In particular practical arrangements for possible contributions under ESIF in line with the respective regulations may be examined.

In this context, the Commission will encourage adjudicating authorities throughout the EU to consider, when economically beneficial, private sector involvement when carrying out infrastructure projects; it will encourage authorities to employ full-life cycle and value-for-money analysis and promote bids relying on a wider range of financing options, fully in line with the recent changes to the public procurement directives. Improving the availability of transparent information and data on new Public Private Partnership (PPP) projects could equally attract institutional investors to European projects.

[39] See http://elite.borsaitaliana.it/en.

[40] The PBI is a risk-sharing instrument created by the Commission and the EIB with the aim to enable project companies to issue project bonds that are attractive to debt capital market investors in the sectors of trans-European networks in transport (TEN-T), energy (TEN-E), and telecommunication and broadband networks.

Despite the importance of infrastructure investment, there is very little consistent pan-European data available on the performance of infrastructure loans. The lack of data was highlighted by EIOPA in their December 2013 report to the Commission as a hurdle that did not it allow to carry out the necessary analysis to recommend a lower calibration of capital requirements for infrastructure assets.

Infrastructure assets are large and sample sizes are therefore smaller than for typical corporate loans. The data is often the proprietary information of banks and equity sponsors and subject to strict confidentiality clauses. Making this data available to the wider market would not only help in widening the institutional investor base but would also help regulators explore the merits of a customised prudential regime for infrastructure investments.

Actions

- The Commission services will evaluate in 2014 the feasibility to voluntarily make available, where possible by way of a single portal, existing information on infrastructure investment plans and projects by national, regional and municipal authorities.
- The Commission services will evaluate in 2014 the feasibility and practical arrangements of collecting and, where possible, making available comprehensive and standardised credit statistics on infrastructure debt within a single access point. This exercise would support the work done in the FSB and the G20 context and could involve the EIB, EBRD, NPBs and institutional investors.

7. ENHANCING THE WIDER FRAMEWORK FOR SUSTAINABLE FINANCE

The ability of the economy to channel funds to long-term financing is also dependent on a number of cross-cutting factors, including corporate governance, accounting, and the tax and legal environment. The general business and regulatory environment is important for domestic as well as cross-border investment.

Corporate governance

The way in which assets are managed can play an important role in long-term financing in terms of aligning the incentives of institutional investors, asset managers and companies on their long-term strategies, and mitigating concerns around short-termism, speculation and agency relationships.

Many stakeholders as well as a large number of empirical studies and reports have highlighted the potential benefits of Employee Financial Participation (EFP) and Employee Share Ownership (ESO) in terms of enhanced productivity and competitiveness, on the one hand, and employee motivation and retention on the other. Such schemes also put in place long-term oriented and engaged shareholders.

There is also substantial evidence about the importance of Environmental, Social and Governance (ESG) issues for the longer-term sustainable performance of companies and investors engaging on these issues. The Commission has already worked on several initiatives to increase corporate transparency by companies, like the proposal on non-financial reporting[41]. However, only a small number of investors take ESG issues into account when building their portfolios and certain investors even consider that integrating such factors would go against their fiduciary duty to maximise returns for beneficiaries.

Actions

[41] COM(2013) 207.

- The Commission will consider a proposal for the revision of the Shareholder Rights Directive to better align long-term interests of institutional investors, asset managers and companies.
- Under the European Parliament Pilot Project on “Promotion of Employee Ownership and Participation“, the Commission will in 2014 assess ESO across the EU with a view to identifying problems with cross-border implementation of EFP/ESO schemes and formulating possible EU actions to promote EFP and in particular ESO.
- The Commission will consider a Recommendation aimed at improving the quality of corporate governance reporting, a report on incentives for institutional investors and asset managers to take better account of environmental (for example carbon footprint and climate risks), social and governance information (ESG) in their investment decisions, and a study on fiduciary duties and sustainability.

Accounting standards

The Green Paper explored the question of balancing the accuracy of the information given to investors with sufficient incentives to hold and manage long-term investments. In this context fair value accounting was criticised by a range of stakeholders for introducing market volatility in financial reports and therefore favouring short-term behaviour. Many respondents commented on the significance of the IASB Conceptual Framework for ensuring that future accounting standards are developed in a way that is not damaging to long-term investment. They also pointed to the ongoing work of the IASB to review the accounting of financial instruments (IFRS 9).

The 2002 International Accounting Standards (IAS) Regulation is being evaluated, including with respect to whether the endorsement criteria established in 2002 are still appropriate and adequately robust for Europe today and for the future[42].

The accounting treatment of SMEs plays an important role in this respect. Many stakeholders have asked for a simplified version for listed SMEs of the full set of IFRS standards applicable to all listed companies, while recognising that robust standards are needed to maintain investor confidence.[43] In addition, for non-listed SMEs a complete self-standing accounting framework could be useful for cross-border groups. Today, non-listed SMEs are subject to national accounting rules based on the recently revised EU Accounting Directive, which sets common basic principles that Member States have to apply when designing their national accounting frameworks for SMEs (*see the Staff Working Document*).

Actions

- In the framework of its endorsement of the revised IFRS 9, the Commission will consider whether the use of fair value in that standard is appropriate, in particular regarding long term investing business models.
- The Commission will invite the IASB to give due consideration to the effect of its decisions on the investment horizons of investors both in specific relevant projects and in its development of the Conceptual Framework, paying particular attention to the reintroduction of the concept of prudence.

[42] See Philippe Maystadt's report "*Should IFRS Standards be More European?*", http://ec.europa.eu/internal_market/accounting/docs/governance/reform/131112_report_en.pdf.

[43] The International Accounting Standards Board (IASB) has developed a set of simplified standards, the so-called IFRS for SMEs. These are however aimed at non-listed companies.

- The Commission services' evaluation of the IAS Regulation will explore with stakeholders in the course of 2014 the appropriateness of the endorsement criteria, taking account of Europe's long-term financing needs.
- The Commission services will launch a consultation in 2014 to examine (i) the case for a simplified accounting standard for the consolidated financial statements of listed SMEs, and (ii) the usefulness of a complete self-standing accounting standard for non-listed SMEs to supplement the Accounting Directive.

Tax and legal environment

A large majority of corporate tax systems in Europe (and internationally) favour financing by debt against equity by allowing deduction of interest costs, while there is no similar treatment for the costs incurred in raising equity. This tax bias towards debt financing may incentivise companies to take on more debt and may penalise innovative companies and start-ups financed through equity. This issue raised considerable interest in the public consultation.

Concerning the legal environment for long term finance, discrepancies between the insolvency laws of Member States and inflexibilities in these laws create high costs for investors, low returns to creditors and difficulties for businesses with cross-border activities or ownership across the EU. These inefficiencies affect the availability of funding as well as the ability of firms to get established and grow, with particular impact on SMEs. In addition, legal hurdles exist regarding the transfers of claims, known in legal terms as assignments of claims, involved in many cross-border financing transactions, such as securitisation and factoring. The absence of a clear regulation at the EU level[44] creates legal uncertainty for cross-border assignments of claims.

Actions

- The Commission will continue, through country specific recommendations in the European semester process, to incentivise equity investment in particular for Member States with high debt bias in corporate taxation.
- As provided for in its Recommendation of March 2014[45] on best practice principles to enable the early restructuring of viable enterprises and to allow bankrupt entrepreneurs to have a second chance, the Commission will review the implementation of the Recommendation and will assess possible additional measures.
- The Commission services will publish in 2014 a report on the law applicable to third party aspects of the assignment of claims.

8. CONCLUSION

Fostering long-term financing is essential for Europe's smart, sustainable and inclusive growth. This Communication sets out a broad range of initiatives on different fronts. Some relate to existing legislation, while others are of a more exploratory nature. They all intend to make the financial system better in channelling resources towards long term investments.

The Commission is committed to implementing this action plan. It will to that effect meet as necessary, and on a regular basis, with all the relevant stakeholders. The Commission calls on Member States and the European Parliament to support the initiatives presented in this Communication.

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[44] Regulation 593/2008 on the law applicable to contractual obligations (Rome I) currently does not expressly regulate this issue.
[45] C(2014) 1500