afme/ Finance for Europe **Association for Financial Markets in Europe**

ECB Financial Integration Conference 2016: High-level Policy Panel II

25 April 2016

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Topics for Discussion

- Reform and harmonisation of insolvency law
- Securitisation
- Role of equity markets, including for SMEs

EU legislation on business insolvency

One piece of EU legislation is already in place...

- Regulation on Insolvency Proceedings – (EC) 1346/2000
- Will be replaced by recast (EU) 2015/848 from June 2017
- The main aims of the Insolvency Regulation are to:
    1. impose rules governing the jurisdiction in which an insolvency proceeding in the EU can be opened and subsequently administered
    2. set rules for the recognition in other member states of those insolvency proceedings and the enforcement of those proceedings

⇒ **A fairly narrow measure, but does provide more clarity**

2014 EC Recommendation

Scope of the EC Recommendation

- In March 2014, the Commission released its "Recommendation on a New Approach to Business Failure and Insolvency" – C(2014) 1500
- This goes further than the 2000 Regulation by recommending minimum standards for national regimes on: (i) preventive restructuring frameworks; and (ii) discharge of debts of bankrupt entrepreneurs
- The Recommendation aims to: lower costs of assessing the risks of investing in another Member State; increase recovery rates for creditors; and facilitate restructuring of cross-border groups of companies

Policy impact

- On 30 September 2015, alongside the CMU action plan, the Commission issued an Evaluation of the Recommendation
- It concluded the Recommendation *"had not succeeded in having the desired impact… because of its only partial implementation in a significant number of Member States, including those having launched reforms."*

AFME policy recommendations

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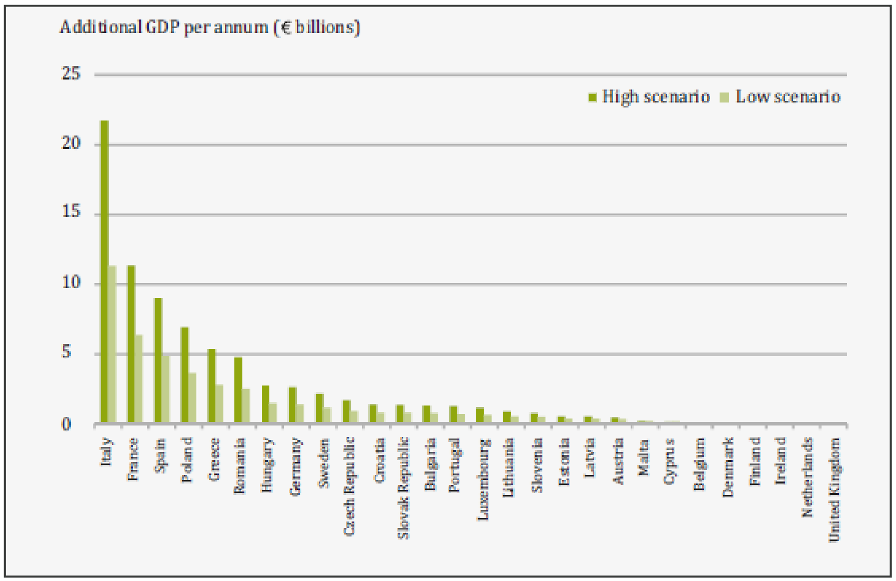
EU legislative proposal	New EU recommendation
Stay Clear, flexible rules and process to stay creditor action against a firm while restructuring is attempted	**Valuation** Recommendations on common valuation methodology based on a 'going concern' metric, for adoption throughout the EU
Ongoing (DIP) financing Ensuring super-priority creditor status for new financing to a distressed company	**Judicial capacity** Development of specialist judicial expertise on restructuring and insolvency cases, both national and cross-border
Cramdown Provisions to prevent creditors with no remaining economic interest in the company from holding up restructuring	**Professional standards** Introducing standards for administrators and insolvency practitioners, in Europe particularly for cross-border cases
Creditor rights Ensuring creditors have the right to propose a restructuring plan for the distressed company	
Reporting Introducing performance reporting by national insolvency agencies (e.g. on costs, timescales and asset recovery percentage)	

Estimating the macroeconomic impact

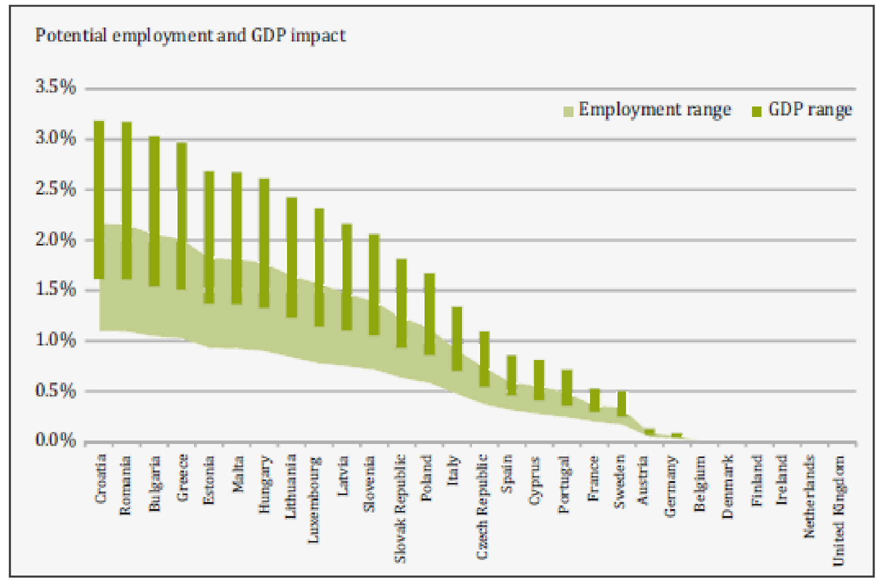
- Frontier Economics, using DataStream and World Bank data, estimates that a 10 percentage point increase in expected recovery rate is associated with fall in bond spread of between 18 and 37 basis points.
- If all EU countries raised their recovery rate to 85%, this should increase EU GDP by €41bn to €78bn over the long term (or 0.3 – 0.55% of EU GDP)
- Total EU employment projected to increase by 600,000 to 1.2 million

Illustrative GDP impact of reform on EU28



Source: Frontier analysis of Datastream, World Bank, S&P, Moody's data

Relative impact of reform by country



Source: Frontier analysis of Datastream, World Bank, S&P, Moody's data

Securitisation - Overview

- A healthy securitisation market is an important sector in well functioning capital markets, and a component of CMU that should be achievable
- AFME welcomes the strong and swift leadership of the Commission, Council and ECB in reviving simple transparent and standardised securitisation ("STS")
- While it is right for the European Parliament to consider matters carefully, recent significant delays are concerning especially because:
  - Most European securitisation can now be seen to have performed very strongly through and since the crisis, supported by 8-9 years of post-crisis data
  - Europe has already implemented, since 2011, the toughest regulatory regime for securitisation in developed markets: risk retention, transparency, liquidity and capital rules
  - The proposals for STS provide an even stronger layer of investor protection, and should be recognised as such in the capital (CRR and Solvency II), liquidity (LCR) and disclosure (EMIR) frameworks
- Securitisation should be treated on a level playing field with other forms of investment. The significant differential treatment that currently exists is undermining the ability to use securitisation as a financing tool in Europe.
- Issuers, investors and many other securitisation market participants have recently spoken with united voices on the detailed steps required to be taken so that the STS proposals create a safe securitisation market able to support the economy:
  - AFME Joint Paper with EFAMA, ICMA and Insurance Europe
  - AFME and 31 other signatories Joint Note submitted to Paul Tang MEP

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Securitisation – Key Principles for STS

- The framework must work for the bulk of the market
- STS must make securitisation attractive for both issuers and investors, especially compared with covered bonds
- Sensible regulatory outcomes on bank capital treatment, Solvency II and the LCR, as well as level playing field, remain crucial
- STS should not seek to remove all risk
- Remember that European securitisation performed well throughout and since the crisis, due to a different originator regulatory regime
- Compliance must be practical, quick and certain for issuers and investors

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Financing European SMEs: Comparison of European vs US capital markets to finance SMEs

SME	Source	Stock (of outstanding financing) US (€B)	Stock (of outstanding financing) EU (€B)	Flow (of new financing in 2013[1]) US (€B)	Flow (of new financing in 2013[1]) EU (€B)
Banks	Loans	464	1,425*	281*	712
Banks	Securitised loans	30	118	5*	36
Banks	Bonds/Equity[2]	Desk research and investor interviews indicate only marginal investments			
	Subtotal	**494**	**1,543**	**286**	**748**
Non banks	Mutual funds	107	88	10	7
Non banks	Segregated Mandates	~5	~10	~1	0
Non banks	Pension Funds[3]	Desk research and investor interviews indicate only marginal investments via funds, mandates or securitisation			
Non banks	Insurance[3]				
Non banks	SWF[3]				
Non banks	Private Equity Funds	59*	32*	14*	9*
Non banks	Venture Capital Funds	104*	22*	26	5
Non banks	Family and friends	371*	168*	186*	84*
Non banks	Crowdfunding	3*	1*[2]	1	1
Non banks	Angel Investing	39*	11*	20	6
	Subtotal	**688**	**332**	**258**	**112**
Government	Government guarantees and sponsored loans	54*	132*	27	66*
	Subtotal	**54***	**132***	**27**	**66***
	Total	**1,236**	**2,007**	**571**	**926**

* Estimates used, see Appendix 2

Key findings – shortfall in available EU risk capital

- Key findings from AFME/BCG research:
- **Europe has a smaller pool of investable assets:** €30tn in Europe vs €49tn in the US
- **Europe has significantly less listed equity capital**: €10tn in Europe vs €19tn in the US
- **Europe's savings market structures are less geared to equity investing**.
    - European pension funds provides €4.3tn in investable assets, vs €14.9tn in the US; 85% of EU private pensions are in two countries (UK, NL)
- **Pension funds' equity allocation is lower in Europe than in the US** (37% vs 53%)
- **EU provides more funding to SMEs than US** (€2.0 trn vs 1.2 trn) but much larger proportion of US funding is provided through equity (US 33% vs EU 9%).

Finance for Europe

Offices

The Association for Financial Markets in Europe advocates stable, competitive and sustainable European financial markets that support economic growth and benefit society.

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