The Netherlands' response to the EC Green Paper on "Long Term Financing of the European Economy"

We thank the Commission for putting the subject of long term financing on the European agenda. Our response first summarizes the main conclusions of the Netherlands, and subsequently goes into detail on the specific questions formulated in the Green paper.

Main conclusions

The Netherlands attaches great importance to the availability of long term finance, as investment is one of the main drivers of economic growth.

For the European Union to take action to increase the availability of long term finance, we need a thorough analysis of the nature and size of the financing need in the Union. We believe that the current analysis in the Green paper and the accompanying Staff working document is still very general. In our view subsequent work is needed, analysing the nature and causes of the (perceived) financing gap. Such an analysis should at least distinguish the fundamental factors on the demand and supply side that influence the availability of long term finance. In particular, the effect of new rules and regulations, such as IORP-2 and especially the interaction between Solvency II and Basel III, should receive attention as these prudential frameworks exert a strong influence on the availability of long term finance.[1] Lack of growth prospects and the poor risk-return profiles of investment opportunities, mainly caused by the enormous uncertainty created by the current crisis, are also of major influence. Hence, measures that alleviate the current crisis are also of key importance to improve the conditions for long term financing.

The Commission analysis should also take into account regional differences within the EU. Financial structures in the Union, although converging, still differ significantly. For instance in some regions, financial markets play a more important role as credit intermediary; in others, banks do.[2] Therefore, uniform measures to improve the availability of long term finance might not be equally effective in all Member States. Finally, more granular information is needed in which sectors and segments of the European economy long term financing is needed most.

On the basis of a more detailed analysis as described above, potential solutions can be explored. In our view all policies should aim primarily at removing possible barriers to the availability and efficient allocation of long term finance, rather than the creation of many new institutions. Although some new institutions are interesting and should be explored further (for instance, credit unions and SME bonds), emphasis on new institutions carries the risk of distorting the functioning of existing sources of finance. Government-guaranteed savings accounts, for example, could supply the (semi-)public sector with investment funds, but would at the same time drain deposits at commercial banks, aggravating their funding problems.

[1] The following is meant by the interaction between Solvency II and Basel III: Insurers will be subject to stricter rules on investments in banks, which can be counterproductive if banks are stimulated to issue types of instruments which insurers are not willing to buy; also, regulations can have double effects (e.g. if both banks and insurance companies find it unattractive to buy securitisations, this funding channel will have a limited market).
[2] Michiel Bijlsma and Gijsbert Zwart, "The changing landscape of financial markets in Europe, the United States and Japan," CPB Discussion Paper 238, 2013.

For attracting long term finance it is also important that Europe remains an attractive location for capital from abroad. To that end, the EU should complete the internal market for services and continue to push free trade agreements with the United States, Canada, Japan and other countries/regions in the near future.[3] In a similar vein, it is important that potential solutions do not lead to barriers to invest outside the EU.

It should also be clear that a possible solution in the view of the Netherlands does not entail a pooling of sovereign issuance among the Member States and the sharing of associated revenue flows and debt-servicing costs.

The Netherlands is not a proponent of introducing saving accounts at the EU level.

In addition, it is important that potential solutions do not lead to financial repression ('measures that cause investors to overinvest in certain desired asset classes') as financial repression hampers the functioning of the internal market. Lastly, on a general level, we believe that potential solutions should not harm prudential regulation, as the Green paper also acknowledges.

The Netherlands would like to ask the Commission to send Member States an overview of all the follow-up actions to the Green paper it is preparing , and the schedule it proposes.

Several specific subjects are important to the Netherlands.

Securitization and covered bonds. The Netherlands agrees with the European Commission that securitization is a useful instrument to obtain funds for long-term projects. We believe that prudential treatment of securitizations should be in line with their fundamentals, taking into account that not all securitizations are equally risky and the comparative performance of securitizations pertaining to other comparable asset classes such as covered bonds. To strengthen this market further, demand for securitization could be increased by improving transparency and standardization. Also, we think that a harmonisation of rules regarding the possibility of asset encumbrance within financial institutions is needed in the EU.

Supervisory frameworks should stimulate rational investment decisions based on adequate risk/return analyses. The combination of market consistent valuation and the draft capital requirements in the draft Solvency II regime lead to suboptimal risk management incentives and suboptimal investment decisions in some cases. Also, long term fixed income investments in non-government paper and investments in SMEs are charged too heavily. This could be solved by improving the capital requirements.

Credit unions and the CRD framework. The Netherlands is in favour of the creation of some type of carve-out for alternative forms of financing like credit unions in the CRD. This would create a better balance between the goals of financial stability (capital requirements) and the ability to provide capital. The current CRD framework is rather rigid for alternative forms of finance: either it fully applies to an entity, or it does not. Priority should be given to the development of a proportionate and flexible regime for alternative forms of finance.

[3] Netherlands Ministry of Foreign Affairs, "De Staat van de Europese Unie 2013," page 19.

Answers to the specific questions

Question 1.

Do you agree with the analysis out above regarding the supply and characteristics of long-term financing?

In the general remarks we already pointed to some dimensions in which the current analysis can be extended. In addition, we think that the demand side of long term finance (which depends on the availability of long term investments opportunities) rather than a focus on the availability of financing alone (the supply side), should be more central to the analysis. As rightly mentioned in the Green paper, companies have increased their savings. In our view, this (at least partly) reflects the poor risk-return profiles of investment opportunities. An important reason for this is probably the enormous uncertainty created by the current crisis. Hence, measures that alleviate the current crisis are also of key importance to improve the conditions for long term financing.

Question 2.

Do you have a view on the most appropriate definition of long-term financing?

We would advocate using a broad definition. On the basis of such a definition certain types/sources of long term financing can then be distinguished (capital market finance, internal financing by companies and the government's taxation returns).

Question 3.

Given the evolving nature of the banking sector, going forward, what role do you see for banks in the channelling of financing to long-term investments?

The Green paper notes that there is room for new intermediaries to channel financing to long-term investments. While we expect alternative sources of long term finance to become more prominent in the future, it is to be expected that for quite some time banks will remain a key channel for long term financing. Initiatives improving the role of banks in channelling financing to long-term investments, such as strengthening the securitization market, are therefore highly important. Banks could also value and manage long term investments for other intermediaries, so without actually placing them on their own book.

Question 4.

How could the role of national and multilateral development banks best support the financing of long-term investment? Is there scope for greater coordination between these banks in the pursuit of EU policy goals? How could financial instruments under the EU budget better support the financing of long-term investment in sustainable growth?

The following are our main observations regarding the financing by development banks:

Long term investment is best supported by the EIB and national investment banks with a strong focus on *specific financing gaps, helping overcome market failure* and *high impact, i.e. transformational investment* opportunities, complementing the role of private banks rather than competing with them. Given the diversity in economic circumstances in different countries, this can in our view only be done by developing (flexible) country specific strategies. Such strategies should not be used as straightjackets (e.g., no volume objectives), but as a method to actively look for the real needs in individual countries.

The EIB and national banks should not primarily focus on offering (slightly) more affordable long term funding for large clients which already have a reasonably good access to bank and capital market funding, but should try to reach out to those parts of the economy which have difficulty attracting (medium to long term) financing against reasonable costs, such as SME's or certain Midcaps. While such clients could continue to be reached through intermediated loans (e,g., through commercial banks), true additionality requires that the EIB and other investment banks accept some of the risk exposure to the ultimate beneficiaries. To the extent that this requires a "deleveraging of their balance sheet" (reducing volume to create more risk capacity) this should be accepted. In all cases conservative prudential ratios and limits should be respected.

To strive for a coordinated approach towards EU policy goals is commendable, but should not be at the expense of the country specificity mentioned above. The EIB and certainly national investment banks should show enough flexibility in the areas which they are able to contribute, as long as it helps to alleviate scarcity of financing, contributes to growth and can be considered sound banking. Long term export financing is one of these areas.

While we appreciate the use of EU funds to blend or guarantee EIB-financing, it is important that the need for such financial instruments is carefully analyzed (pilot phases) and that they do not become too fragmented, rigid (funds that have to be used for very specific purposes even if there is not enough demand) or would not rely on sound banking principles. Ideally the risk taking capacity of the EIB itself should be increased (by less focus on volume).

In the same vein we feel the operational relationship between the EIB and EIF needs to be revaluated, with an eye to assessing whether the operational capacity of the EIF could and should be increased in view of the fact that the largest scarcity of funding is concentrated in the niche areas of the EIF (SME's and venture capital).

Where possible, cooperation and expertise on long term financing could be sought from other multilateral institutions.

Question 5.

Are there other public policy tools and frameworks that can support the financing of long-term investment?

Some long-term investments are traditionally done by government, for example investments in education, transport, infrastructure or water management. The government can, however, choose to finance these projects directly, or set up a sound framework for PPPs (public private partnerships). The latter could offer interesting savings for the government, which help to repair government budgets and/or create more room for investments. It is therefore interesting to broaden the private financing market for PPP as this will lead to more competition and therefore to better rates and cheaper projects. In its PPP projects, the Dutch government does not favour a specific financing option but is open to different forms of financing (e.g., from banks and institutional investors) without preference or particular enhancements or incentives. The government provides a clear and efficient framework for the partnership whereas the private sector is responsible for finding optimal financing solutions as it has the best incentives and expertise. It is important to bear in mind, however, that private financing is not a goal in itself. It is a means to gain value for money for tax payers, provides discipline and enhances risk management. Yet government must retain the option of financing projects publicly if private finance turns out to be more expensive, complex or high-risk.

As PPP can be a cost-effective option for financing projects by the government, the Commission could consider whether projects funded by EU structural funds can/should also be funded (more often) by PPP-like set-ups.

Another way to stimulate long-term finance works through governmental export credit guarantee schemes, which can provide valuable support to investments requiring long-term finance. The Staff paper rightly mentions this. In many cases, the availability of such an export credit guarantee is a prerequisite for banks to provide long term financing. Such governmental guarantees enhance the risk profile of the banks.

As a result of the credit crisis, banks have fewer possibilities for lending and at the same time, the Basel rules require them to strengthen their capital base. This means financing by banks has become less available and/or more expensive, even with governmental guarantees. It can therefore be worthwhile to look at newly created possibilities of government supported tools for non-bank providers of long term finance. As in several countries, the Netherlands designed an Export Credit Guarantee scheme. In order to provide the banks with new funding possibilities, the Dutch state is prepared to give an unconditional payment guarantee to investors providing this funding.

In chapter 9 of the staff paper, discussing public policy instruments, the suggestion is raised to analyze the possibility of launching an EU Export Credit Agency to help financing, particularly outside the EU. At this moment we do not see the necessity of such an EU agency, but we do not oppose exploring the possible role of export credit with regard to long term finance and investments on the European level. This broad analysis might then also address the necessity for an EU Export Credit Mechanism and should not necessarily be limited to a role outside the EU, but could also focus on possible added value of such an approach for large EU projects.

Finally, the Green paper mentions that depositors generally have somewhat shorter horizons when it comes to investing. In this regard, a capital-based pension system can help channel funds to long-term investors. Pension funds, however, should not in any way be forced to invest at home or abroad.

Question 6.

To what extent and how can institutional investors play a greater role in the changing landscape of long-term financing?

Question 9.

What other options and instruments could be considered to enhance the capacity of banks and institutional investors to channel long-term finance?

The core task and competence of institutional investors such as pension funds and insurers is to find the best investment opportunities for their policy holders or participants. Pension funds are required by European law to invest in the sole interest of their members and beneficiaries in accordance with the nature and duration of the expected future retirement benefits ("prudent person- principle", article 18 IORP-directive). They are keen to find the best risk/return opportunities, but are also required by European law to ensure the security, quality, liquidity and profitability of the portfolio as a whole. A key element of the risk management required is diversification, both in terms of asset classes and geographical scope of investments.

Any proposals promoting the involvement of institutional investors with long term investments should fit these investment conditions. Durable long term investments in Europe can only be reached by further stimulating rational investment decisions based on adequate risk/return analyses and by improving a climate for investment in Europe attractive to both European and non-European investors. Long term investment should benefit both institutional investors and the parties requiring funding. Even in times of economic distress/downturn, a rational assessment of risk/return opportunities remains key, as suboptimal investment would (in the end) be both to the detriment of policy holders/pensioners, parties seeking capital funding and the European climate for investments .

Therefore, any adjustments to regulation in order to promote long term investments in Europe, whether rules on prudential supervision or regulation of a different character (fiscal , taxes etc.), should not prevent institutional investors in finding the best risk/return opportunities for their clients. Supervisory prudential requirements should not be too prescriptive nor rule-based. In our view institutional investors could play a greater role in the changing landscape of long- term financing by removing observed regulatory hurdles that (could) result in suboptimal investment choices. In the Netherlands the government is currently hosting talks with institutional investors to see whether national hurdles to investment can be removed and investment opportunities with appropriate risk/return conditions can together be explored.

Insurers

Insurers could be allowed to work with a so called internal model approach within Solvency II. Currently, the specifics of the standard approach within Solvency II make it unattractive for insurers to apply a diversified investment strategy or to be active in a niche market. This is because the standard approach makes investing in various investment categories too costly (see also our answers to question 7). The adoption of an internal model brings about large costs. Smaller and medium sized insurers cannot afford such costs. This imbalance between the standard and internal model approach is to the detriment of medium sized insurers and thereby their investment opportunities in long term finance.

- We therefore propose a review of the internal model approach of Solvency II in order to find out whether it can be made more suitable for medium sized insurers too. In addition it could be analysed whether in these approaches there is enough room for innovative investments opportunities.

Pension funds

As you know, the Netherlands have expressed serious concerns with the IORP review and the direction for reform proposed in EIOPA's draft response to the Commission's Call for Advice on several occasions, particularly on the issuing of new maximum-harmonising solvency rules. We think there is a strong case against reform on the basis of the high risk of serious harm to pillar 2 pension provision, high increase of labour cost and a negative effect on economic growth. Against this background and the minimum-harmonisation character of the current IORP, we think that the identification of hurdles in prudential supervision or regulation that (could) result in suboptimal investment choices will primarily have/remain to be addressed at national level.

Question 7.

How can prudential objectives and the desire to support long-term financing best be balanced in the design and implementation of the respective prudential rules for insurers, reinsurers and pension funds, such as IORPs?

We observe a trend in Europe to improve the prudential rules for insurers, reinsurers and pension funds towards risk based rules. This is a way forward that we do appreciate in principle. However, we have to refer to the strong objections of the Netherlands with regard to the IORP review and the direction for reform proposed in EIOPA's draft response to the Commission's Call for Advice.

It is essential that similar risks are addressed equally in a risk based framework. It is also important that all investment categories are also treated equally relative to each other. Some might find it tempting in the current economic circumstances to create incentives towards long term investments in prudential regulation by organising preferable treatment of certain investments, for instance via preferential capital charges relating to assumed risks. However, we do not think this should be the way forward, as such an approach would ultimately result in suboptimal prudential supervision, market distortions and suboptimal investment decisions.

Currently, proposals regarding new risk based supervisory rules are most detailed for insurers. In answering this question, we therefore focus on the lessons learned from Solvency II .

We are of the opinion that the combination of market consistent valuation and the current draft proposal with respect to the capital requirements could in some cases lead to suboptimal risk management incentives. Market consistent valuation gives insurers incentives to invest in high rated bonds/securities as their market value is less volatile and to match the duration of the bonds/securities with the duration of the liabilities. The better the Asset Liability Management, the less volatility of own funds, one would expect.

However, in Solvency II market consistent valuation is combined with capital requirements that include a Spread Risk Module, which is for example applied to investment in bonds and structured financial instruments (fixed income investments). The capital charge, as prescribed by this Spread Risk Module, is based on the change in own funds that results in an increase in the spread risk of the specific bond/instrument. This capital charge is related to the rating and duration of the bond/instrument. This introduces a pro-cyclical element in the Spread Risk Module. In effect, a bond downgrade results in a lower market consistent value and consequently an immediate reduction of the own funds. At the same time, the capital charge increases due to the down grade. The longer the duration of the bond, the higher the increase in capital charge will be. This makes long term investments in bonds extra unattractive. We therefore propose that capital charges are calibrated in such a fashion that the risk awareness already introduced by the market consistent valuation is taken into account to mitigate this procyclicality. In addition, stress testing should be used in assessing the levels of surplus capital that an insurer needs to absorb the volatility in own funds caused by the market risks, such as spread risks. Within Solvency II the supervisor can take prudential measures such as an capital add if the risks involved are too large.

Another area of improvement within the current Solvency II framework could be the treatment of mortgage loans of SMEs. These are currently to be treated as loans without collateral. This means that the Spread Risk Module should be used. These loans are non-rated and therefore are to be treated as the lowest quality of loans, which results in the highest capital charge. A long term mortgage loan of a SME is thereby one of the least attractive investment categories for insurers.

A final area of improvement could be the treatment of Asset Backed Securities. In the case of a structured financial instrument, the shock applied by the Solvency II rules will be calculated for all underlying tranches held. However, the choice of underlying investments such as bonds, commercial mortgages or residential mortgages is not relevant for the level of the shock: the most prudently calibrated shock is required. For the calibration of the shock, the data of the US Asset Backed Securities market during the financial crisis are used. Yet this means that currently, investments in European Asset Backed Securities face higher capital charges than investments in emerging market equities. This makes investments in structured products - especially those with a relative low risk profile and consequently low returns such as European residential mortgages based securities - unattractive. As Asset Backed Securities are often used by banks to fund their long term investments, this thus makes it harder for insurers to fund banks. Note, however, that in the specific case that the bond is an EEA government bond, the spread risk charge is zero. Because of this calibration, insurers face disincentives to invest in ABS.

<u>In sum, we have the following suggestions to improve the prudential treatment of long term investments in Solvency II:</u>

- The difference in capital charges between EEA-government bonds and corporate bonds should be reduced.
- The market risk modules should be constructed/calibrated in such a way that the risk awareness caused by the market consistent valuation is taken into account.
- The collateral of SME mortgage bonds should be taken into account in the capital charges.
- Capital charges for Asset Backed Securities should be lowered and based upon the European market.
- Stress testing is crucial in assessing the levels of surplus of capital that is needed in order to absorb the volatility in own funds that is part of market consistent valuation. This should be included in the supervisory reporting, harmonised at the European level.

With regard to prudential rules for pension funds we have to reiterate that, in our opinion, the balancing of prudential objectives and the desire to support long-term financing identification will primarily have/remain to be addressed at national level.

Furthermore, rules regarding the prudential supervision of IORP’s should not undermine the efforts of Member States to promote complementary long-term retirement savings as these savings can help secure adequate replacement rates in the future. The proposals for reforming the financial markets have already raised the costs of funded private pension schemes considerably. Any further cost increases or restraints on pension funds could discourage further savings in private pension schemes and seriously jeopardize the adequacy and sustainability of pensions. The relevance of promoting complementary retirement savings to enhance retirement incomes was emphasized by the Commission in its 2011 and 2012 Annual Growth Surveys (AGS) and in its White Paper on Pensions in the context of the need for reforms of pension systems and retirement practices, as they are essential for improving Europe's growth prospects and are urgently required in some countries as part of current actions to restore confidence in government finances.

Question 8.

What are the barriers to creating pooled investment vehicles? Could platforms be developed at the EU level?

We do not observe barriers to creating pooled investment vehicles: under UCITS IV, UCITS are now able to pool their assets in master-funds.

With regard to the second question, we are uncertain what is meant by "platforms at the EU level": a) supranational platforms or b) (national) platforms active within multiple EU member states. The former option would require a major institutional overhaul for which currently no rationalization can be given. The latter option is already possible under MiFID, which defines the Multilateral Trading Facility as a trading venue regulated under MiFID.

The European Commission has proposed to recast MiFID and introduce a (new) Regulation on market in financial instrument ("MiFIR"). One of the proposals within this MiFID2-regime introduces a new (regulated) trading venue: the Organised Trading Facility . The MiFID-2-regime also introduces a trading obligation for (standardised and liquid) derivatives. This trading obligation will increase the volume of transactions on regulated trading venues.

MiFID ensures that all types of multilateral trading in financial instruments take place on transparent (regulated) trading venues. Current non-transparent ("dark") multilateral trading venues have to change their business model and become a regulated trading venue.

Question 10.

Are there any cumulative impacts of current and planned prudential reforms on the level and cyclicality of aggregate long-term investment and how significant are they? How could any impact be best addressed?

There have been major concerns about the pro-cyclicality of market consistent valuation in G20 and Ecofin discussions in the aftermath of the crisis. In Solvency II, these concerns are addressed through proposals such as the introduction of the illiquidity premium, the mandate given to EIOPA to extend the recovery period in times of crisis and the introduction of Binding Technical Standards by EIOPA on additional rules regarding market consistent valuation. The purpose of those measures is to maintain transparency for investors, but at the same time reduce excessive volatility in the system that is not based on economic fundamentals. An issue that came up during discussions with stakeholders after the QIS5-exercise is how capital requirements interfere with market consistent valuation. The combination of market consistent valuation and the risk based capital requirements should give the proper risk management incentives (see also our answer to question 7).

In fact, when market consistent valuation already offers the proper risk management incentives, the capital requirements should not give this same incentive again but should instead be set more neutral to risks that are taken into account in the accounting base. Risks that are not given the proper incentives in the accounting base (e.g. because of the use historical cost accounting), should be added in the capital requirements. The combination of accounting and capital requirements should give the proper risk management incentives.

In order to provide greater insight into the influence of pension funds investment behaviour on the economic cycle, De Nederlandsche Bank (DNB) studied the investments by pension funds during the financial crisis (October 2008-March 2009). The research shows that at the peak of the financial crisis, on balance, the overall investment behaviour of the 40 largest pension funds in The Netherlands was (slightly) anticyclical. DNB found considerable differences across these funds. No link was observed between the degree of rebalancing and the funding ratio. Research by the OECD[4] neither provides clear evidence for pro-cyclical investment behaviour by pension funds as a result of changes in solvency regulation and accounting standards in The Netherlands, but – in general - does not rule out any effects of risk based capital charges and 'fair valuation' of assets on risk/return considerations by institutional investors either. It is important to study these matters in a broader context, as policy decisions by pension funds are not only a result of risk based valuation of assets but also of other aspects of a prudential framework. For instance, measures to reduce (artificial) volatility in the market-based discount rate as well as a reasonable recovery periods, that can be extended in times of crises, can prevent policy decisions based on artificial market volatility or mitigate any procyclical effects. These studies should be dealt with in the context of the IORP review.

Question 11.

How could capital market financing of long-term investment be improved in Europe?

Question 12.

How can capital markets help fill the equity gap in Europe? What should change in the way market-based intermediation operates to ensure that the financing can better flow to long-term investments, better support the financing of long-term investment in economically, socially and environmentally sustainable growth and ensuring adequate protection for investors and consumers?

Several sets of regulation have recently been implemented with the aim of improving the functioning of capital markets in Europe. The Regulations on European Venture Capital Funds and on European Social Entrepreneurship Funds and the Alternative Investment Fund Managers Directive will reduce regulatory differences (and therefore complexity) within the Union, and thus make raising capital on a cross-border basis easier. By creating a European system for cross-border fundraising, long-term financing for investment will become more accessible. The functioning of these rules will be reviewed in the upcoming years. As regulations take time to take effect, we would recommend against further regulatory reforms in this area until the full effects of previous reforms are known.

[4] OECD working papers on finance, insurance and private pensions, no. 30, "The effect of solvency regulations and accounting standards on long term investing".

As mentioned in the answer to question 5, in specific cases the government can stimulate capital market financing of investment through PPP initiatives.

Question 13.

What are the pros and cons of developing a more harmonised framework for covered bonds? What elements could compose this framework?

Question 14.

How could the securitization market in the EU be revived in order to achieve the right balance between financial stability and the need to improve maturity transformation by the financial system?

Covered bonds and securitizations are commonly used as sources of long-term financing for banks. However, we do not consider the harmonization of covered bonds a top priority, as bond holders seem to be well able of coping with the diversified regulatory environment. Main issues to be addressed with harmonization would be the insolvency remoteness of the cover pool, the status of its owner and the assets allowed in the cover pool. Also, we note that long term financing will only increase to the extent that covered bond issuers use the proceeds for this purpose and that greater use of covered bonds implies a higher asset encumbrance, which is detrimental to (among others) depositors, as they are more junior than covered bond holders.

From the issuer's perspective, securitizations can be safer than covered bonds (no overcollateralization, no asset encumbrance). The inadequate insight in securitizations, which contributed to excessive leverage and the start of the banking crisis in 2008 in the US, is being addressed by stricter regulation on securitization, including capital requirements, retention rules, and liquidity ratios. However, prudential treatment of securitizations should be in line with their fundamentals, taking into account that not all securitizations are equally risky and the comparative performance of securitizations pertaining to other comparable asset classes such as covered bonds. Concerning current regulatory proposals, we therefore propose the following approaches:

- *Solvency II and IORP:* Calibration of RMBS capital charges should be based on European, not solely US, data, due to differences in market fundamentals.
- *Bank liquidity rules:* Furthermore, securitizations remain an important source of funding for banks. Banks should be able to treat high quality liquid RMBS as such. The latest BCBS on the liquidity coverage ratio (January 2013) should therefore be included in European regulation after EBA has performed the review designed in CRD IV.

Demand for securitizations could be increased by improving transparency (to assist making informed investment decisions investors) and standardization (such as standardized asset level templates). These practices are already being developed and implemented by the market. We therefore do not see a need for public EU-wide initiatives to encourage long-term investors to buy securitizations.

Question 15.

What are the merits of the various models for a specific savings account available at the EU level? Could an EU model be designed?

Savings accounts are already offered by several governments. Money stored in these savings accounts is often exempted from taxes and in several cases, depositors receive a guaranteed return on their savings (indexed to inflation). The rationale for these saving accounts is that governments can use the funds in these accounts for long term investments.

However, two important risks are associated with government-offered savings accounts. Firstly, due to their attractive features for depositors, they could drain funds from ordinary bank deposits, leading to an increase in the funding costs of banks. Secondly, the guaranteed return on the account poses a risk to the government budget. Both risks are usually mitigated by capping the amount that can be stored in the savings accounts, or by limiting the number of products available. Nevertheless, limiting the distortionary effects of the savings accounts appears to be challenging as it remains difficult for the private sector to compete with the terms of the savings accounts (tax exemptions and/or guaranteed returns).

Offering this kind of savings accounts at the European level could therefore lead to a decrease of deposit savings at a time when the European banking sector is faced with significant funding challenges and deleveraging. This could thus affect the flow of long-term investment financing by the financial sector. An alternative setup, in which private banks offer the government-backed savings accounts, suffers from other problems as these could influence the efficient allocation of savings. According to Standard and Poor's, several existing savings accounts allocate funds away from more productive investments. Apart from that, one could also question the added value of these accounts relative to other instruments for saving. Therefore, the Netherlands is not a proponent of introducing these accounts at the EU level as we already are not in favour of introducing them at the national level. Finally, the introduction of such accounts at the EU level would pose additional governance issues (who should govern these accounts, what is their investment mandate, how should the money be allocated to different member states).

Question 16.

What type of CIT reforms could improve investment conditions by removing distortions between debt and equity?

Question 17.

What considerations should be taken into account for setting the right incentives at national level for long-term saving? In particular, how should tax incentives be used to encourage long-term saving in a balanced way?

Question 18.

Which types of corporate tax incentives are beneficial? What measures could be used to deal with the risks of arbitrage when exemptions/incentives are granted for specific activities?

Question 19.

Would deeper tax coordination in the EU support the financing of long-term investment?

The Dutch government recognizes the importance of the long term investments for the growth of the economy. However, granting tax advantages has to be regarded in a more general context and not just in a discussion on long term financing. Both in the OECD and the EU, a more equal treatment of equity and debt capital is already being discussed in a more general fashion. The Netherlands attaches great value to these international discussions and the element of access to long term finance can be integrated in them. Once common ground is found at the international level, further technical work can be done on a national level, as tax issues are a national prerogative.

Question 20.

To what extent do you consider that the use of fair value accounting principles has led to short-termism in investor behaviour? What alternatives or other ways to compensate for such effects could be suggested?

The Netherlands believes that it is not fair value accounting that has led to short-termism in investor behaviour.

In the years before the crisis we have seen an enormous rise in transferable financial products. The fact that financial institutions such as banks and insurers started to use them more too, made them more dependent on the volatility of prices in the financial markets. One of the reasons may be that Basel II legislation contained an implicit incentive to reduce capital charges by making non-transferable financial products (such as mortgages) transferable by securitization.

All measurement systems have pros and cons. One of the cons of measurement at cost rather than fair value for on financial markets transferable products, is the lack of transparency, increasing the information asymmetry between the agent and the principal. Furthermore, the Japanese financial crisis has shown that banks can hide their poor performance by selling liquid financial instruments (measured at cost) at the end of the year and buying them back at the beginning of the next year

In our opinion, fair value accounting for non-transferable financial products (for example required in Solvency II) should be used with more caution. For these products the risks associated with the estimation of cash flows should be calibrated on attributable risks that cash flows will not be collected or paid.

As said in our answers on questions 7 and 10, the Netherlands believes that short-termism in investor behaviour should be solved by careful calibration of both accounting and capital requirements for prudential supervision.

Question 21.

What kind of incentives could help promote better long-term shareholder engagement?

Dutch law contains provisions that stimulate and encourage (long-term) engagement by shareholders. Examples are the duty of the management and supervisory board to provide to the general meeting all the information it requests (art. 2:107 Dutch Civil Code, hereafter: DCC), the convocation of a general meeting by shareholders (art. 2:110-112 DCC), the right to attend and vote by proxy (art. 2:117 DCC), the right to add items to the agenda of the general meeting (art. 2:114a DCC) and participation in the general meeting by electronic means. Furthermore, a new law will come into force as of 1 July 2013, facilitating the identification of shareholders. The identification can encourage a constructive dialogue between companies and their shareholders.[5]

There is no specific legislation to encourage long-term ownership in the Netherlands. In expert meetings with academics and representatives of shareholders and companies in 2009 and 2011, the need for such legislation, for example multiple voting rights or dividend for 'loyal' shareholders, was discussed. It was concluded that benefits of such legislation are unclear, while disadvantages are to be expected. Dutch law offers enough possibilities to companies and shareholders to facilitate long-term ownership. We do not see problems in this area that need an EU-level solution. However, a European proposal for the identification of shareholders could be useful, considering the international character of shareholding / holding chains of shares.

Question 22.

How can the mandates and incentives given to asset managers be developed to support long-term investment strategies and relationships?

This question relates to the contractual relation between a shareholder (e.g., institutional investors) and an asset manager. It is the responsibility of the shareholder while giving the asset manager the assignment, to set such conditions that the asset manager acts in accordance with the (long-term) strategy of the shareholder. Some of these aspects are already dealt with in European directives, such as MiFID, AIFM and UCITS. For the moment, we see no need for further European initiatives.

Question 23.

Is there a need to revisit the definition of fiduciary duty in the context of long-term financing?

Regardless of the contents of the definition of fiduciary duty, an asset manager is held to act in the interest of the investor. It may or may not be in the interest of the investor to make a long-term investment. This depends on the specific situation and risk-profile of the investor. Therefore, we do not see a need to revisit the definition of fiduciary duty.

Question 24.

To what extent can increased integration of financial and non-financial information help provide a clearer overview of a company's long-term performance, and contribute to better investment decision-making?

The current model of financial reporting mainly focuses on financial performances. The Netherlands believe that the disclosure of non-financial information could provide a clearer overview of a company's long-term performance insofar that reporting provides a clear and concise representation of how an organization creates value, not only now but also in the future.

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[5] Wet van 15 november 2012, Staatsblad 2012, 588.

The disclosure of non-financial information is only worthwhile if that information is relevant for the business of the company and valuable for internal and external stakeholders. As the relevant information may vary for each company, flexibility is necessary. Apart from that it should be clear which role auditors can play in contributing to the reliability of the information reported. Attention should also be paid to the administrative burdens for companies.

Question 25.

Is there a need to develop specific long-term benchmarks?

The need for any long-term benchmark is dependent on demand from the market(long-term investors or companies who want to attract long-term investors). In developing any long-term benchmark, we should be aware that they do not trigger sole and mechanistic reliance on it. The Dutch government would appreciate more concrete ideas on what kind of benchmarks one could think of in the follow-up to the Green paper.

Question 26 and 29.

What further steps could be envisaged, in terms of EU regulation or other reforms, to facilitate SME access to alternative sources of finance?

Would an EU regulatory framework help or hinder the development of this alternative non-bank sources of finance for SMEs? What reforms could help support their continued growth?

Several ways to improve the access of SMEs to finance could be thought of. SME bonds, SME funds, credit unions and crowd funding are examples of initiatives complementing traditional sources of finance.

Crowd funding and credit unions
In the Netherlands, several initiatives for the financing of SMEs through crowd funding and credit unions have been set up. Depending on their exact business model, a license of the Dutch financial market supervisors (the AFM and DNB) is required. We are not yet convinced of the desirability and need for (European) regulation of crowd funding/credit unions by formulating a completely new framework.

The main issue with promoting credit unions as financial intermediaries is in our view the applicable regulatory framework. While credit unions in the UK and Ireland are exempted from CRD, they are not in some other countries . The CRD framework is rather rigid in this respect: either it fully applies to an entity, or it does not. This creates an imbalance between the goals of financial stability (capital requirements) and the ability to provide capital. The Netherlands is currently investigating the creation of a supervisory framework in line with CRD but with specific attention to the characteristics of credit unions. At a European level it might be worthwhile to consider whether there should be a general exemption (of certain parts) within the CRD for alternative sources of SME funding such as credit unions.

Other alternative sources of finance

Currently, we do not see a need to consider the creation of new, or the evaluation of existing EU regulation regarding alternative sources of finance (with the exception of the points mentioned above) as they are not a guarantee to the development of new markets. New phenomena like crowd funding, SME bonds and credit unions are inherently diverse and hard to define, which makes them hard to regulate ex ante. Small local initiatives (with little to no cross border activities) might best be regulated locally.

Question 27.

How could securitisation instruments for SMEs be designed? What are the best ways to use securitisation in order to mobilise financial intermediaries' capital for additional lending/investments to SMEs?

Question 28.

Would there be merit in creating a fully separate and distinct approach for SME markets? How and by whom could a market be developed for SMEs, including for securitised products specifically designed for SMEs' financing needs?

Securitised products for SMEs are already available; however, they are not widely used. Generic measures like increased standardization of the loans underlying the securitisations, and improving the information available about these loans, could help increase the demand for SME securitisations.

Current problems for SMEs are different and more severe than for other corporates, which could justify a distinct approach. For example, they are more dependent on bank funding. Investigating the alternative sources of finance for SMEs is important, and the Netherlands in the process of doing so.

Markets for funding and the perceived problems confronting these markets differ significantly between member states. EU-level action should only be applied to problems occurring in at least most of the member states. The Commission could look in more detail at the differences between member states. Although the Commission Staff Working Document acknowledges the existence of differences between Member States, it lacks an analysis of the causes and implications of these differences.

Question 30.

In addition to the analysis and potential measures set out in this Green paper, what else could contribute to the long-term financing of the European economy?

For attracting long term finance, it is important that Europe remains an attractive location for capital from abroad. To that end, the EU should complete the internal market for services and continue to push free trade agreements with the United States, Canada, Japan and other countries/regions in the near future.[6] In a similar vein, it is important that potential solutions do not lead to barriers to invest outside the EU.

[6] Netherlands Ministry of Foreign Affairs, "De Staat van de Europese Unie 2013," page 19.