CREFC Europe responses to COM CMU Green Paper

1. Beyond the five priority areas identified for short term action, what other areas should be prioritised?
No response.
2. What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?
We note that when the Bank of England consulted on better SME credit information in 2014, it also consulted on the potential value of better information about commercial real estate (CRE) credit markets. We believe that the Commission should consider doing so as well, or at least follow developments in the UK with active interest. In important respects, the informational and transparency challenges of the CRE credit market are quite different from those of the SME credit market. Because CRE lending primarily involves taking risk on the income generating capacity and value of CRE assets, rather than on the credit quality of the borrower, it is not necessary to expand lenders' access to individual SME credit information. On the other hand, CRE is a highly cyclical market with potentially dangerous feedback loops between the property cycle and the credit cycle. Information to help lenders (and debt investors), as well as regulators and others, to assess where in the cycle the market sits at any given moment could make a valuable contribution to improving market and financial system stability and resilience. In its May 2014 report, "A Vision for Real Estate Finance in the UK" (uploaded with this response)[1], an independent UK CRE industry group, the Real Estate Finance Group, set out a clear explanation of how a comprehensive, confidentiality protecting but publicly accessible CRE loan database could support both macro-prudential supervision and the market (see Recommendation 1 of that report). We believe the Bank of England was right to respond to its consultation by concluding that a proposal along those lines should be taken forward.
3. What support can be given to ELTIFs to encourage their take up?
We agree with other commercial real estate organisations that there is a need for additional guidance concerning the ELTIF requirement that, to be ELTIF-eligible investments, residential and commercial real estate must be integral to or an ancillary element of a long-term investment project that contributes to smart, sustainable and inclusive growth in Europe or the EU's energy, regional and cohesion policies. The wording of the requirement is too vague for potential investors and fund managers to determine what real estate investments would be eligible, which does not encourage take-up of ELTIFs. In addition, the more broadly these investment eligibility requirements are interpreted, the more likely it will be that ELTIFs will be attractive to investors. We also believe that clarification that the scope should be interpreted broadly would be consistent with the policy objectives of the ELTIF initiative.
4. Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?
No response.

[1] See http://www.ipf.org.uk/industry-involvement/a-vision-for-real-estate-finance-in-the-uk.html.

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

Commercial real estate (CRE) – the missing piece in the Commission's CMU vision?

We note that, despite the Commission's understandable focus on SMEs and infrastructure, the Green Paper effectively ignores a critically important sector that straddles and supports those two engines of growth: the CRE industry. The CRE sector directly contributed EUR 302 billion to the European economy in 2013, the last year for which we have full-year figures, representing about 2.6% of the total European economy (these and other figures given in this response are drawn from the 2014 industry report, "Real Estate in the Real Economy", uploaded with this response)[2]. This is more than either the European automotive industry or the European telecommunications sector. The CRE sector in Europe employs 3.8 million people, which is, again, not only more than either the automotive industry or the telecommunications sector, but also greater than banking.

Around 40% of all CRE – with a total market value of over EUR 2 trillion – is held as an investment. The CRE investment industry provides a quasi-financial service to ordinary businesses, by providing premises on flexible terms for rent. Without this industry, small and growing businesses in particular would face considerable challenges in securing appropriate premises. Without a professional CRE investment industry, businesses would be forced to build or buy commercial premises, and opportunities to scale up or down in response to changing circumstances and business needs would be far more limited. In order to provide its quasi-financial services to the wider economy, the CRE investment industry needs a combination of equity and debt capital. That is particularly the case in regional and smaller ticket size markets. It follows that a sustainable flow of credit to the CRE investment industry is (indirectly) essential for the wider economy.

There are two further strong bonds between CRE and SMEs. First, the CRE industry is itself largely an SME industry, with only a fairly modest proportion of investment CRE owned by large businesses with relatively reliable and affordable access to credit and capital. Maintaining a sustainable flow of credit across the cycle for the CRE industry, including for relatively higher risk but economically vital construction and development projects, is therefore a question of credit flow to SMEs. Secondly, for many non-CRE SMEs that own the premises from which they operate, access to credit is made possible, or more cost-effective, if they are able to give security over their business premises to a lender. As a result, the flow of credit to many SMEs and the real economy is significantly affected by the property cycle.

The CRE industry makes an essential contribution to the economy by enhancing productivity through the varied and flexible provision of accommodation for businesses and people and their changing needs. It also plays a leading role in tackling climate change by encouraging and adopting technical innovation in building design and the retrofitting of existing buildings. Finally, office buildings and shops are essentially the urban infrastructure without which we would have no towns or cities.

CRE and infrastructure investment

CRE and infrastructure both form an integral part of our urban environment and to a significant extent they are interconnected. CRE development is generally only possible when it can be serviced with good transport, energy and communications infrastructure. At the same time the provision or extension of such infrastructure often only makes sense where it connects with buildings where people live, work, shop and enjoy leisure activities, or where it will lead to future CRE development.

It is also difficult to draw a line between CRE and infrastructure investment, particularly when it

[2] See https://www.inrev.org/news/31-publications/public-affairs/742-real-estate-in-the-real-economy.

comes to social infrastructure such as healthcare, educational and leisure facilities. While in many European countries such facilities may historically have been provided by the state, institutional and private capital is increasingly investing in such projects for both profit and social investment motives. In addition, CRE developers are often responsible for the public realm and urban infrastructure immediately surrounding their projects, such as green spaces, transport links and public information amenities. This further emphasises the connection between CRE and infrastructure.

An important source of income for European savers and pensioners

CRE can serve as a long-term investment for institutional investors and households. The long-term cash flows generated from CRE rental streams provide an important source of diversified income in the portfolios of European savers and pensioners. Real estate in its various forms accounts for EUR 730 billion of European pension funds' and insurance companies' investments, an average allocation of nearly 6%.

Pension funds' and insurance companies' exposures to CRE is effectively higher than EUR 730 billion because listed property companies and unlisted real estate collective investment vehicles (like private households), often use debt to enable them to boost the amount of property they hold. Including debt taken out that is generally secured by the property, European pension funds' and insurance companies' beneficial interest in commercial and residential property is closer to EUR 1 trillion.

Institutions also invest (through their fixed income allocations of capital) in CRE debt itself, providing finance to other CRE owners through the bond market, loan syndication markets, debt fund investments or in some cases their own direct lending platforms. CRE debt has different investment characteristics than investing in ownership of CRE - in general terms, it is lower risk and lower return - but it too is attractive to pension funds and insurers. Since the crisis, CRE debt has begun to feature more prominently alongside other forms of real estate investment as an investable asset class, albeit reliable European data is difficult to come by.

Distortive effects of recently enacted regulations

In the light of the above, it is important that the regulatory environment recognises the important role that the CRE industry plays in the provision of infrastructure. We are concerned that this is not currently the case, and are especially troubled by the capital charges proposed under Solvency II. Under this regime's standard model, direct investment in CRE carries a 25% risk weighting; a level set by reference to data from the EU's most volatile real estate market, the UK. A review of Solvency II by independent research organisation IPD using data representative of European property market volatility clearly demonstrates that it would be unreasonable to impose a capital solvency charge of more than 15%.

Solvency II's treatment of lending against commercial real estate is similarly inappropriate, as it does not allow insurers to take appropriate account of the collateral or security value of the asset being funded. This results in insurers facing capital charges that are disproportionately high compared to the actual risk of loss.

While the capital charges attributable to direct CRE loans by insurers are (as one would expect) significantly lower than the 25% charge applicable to exposure to the CRE asset itself, the charges applicable to securitised CRE debt (commercial mortgage backed securities or CMBS) are penal and quite absurdly high. The charge of a typical five year duration CMBS bond ranges between 62.5% for the very safest, AAA rated tranche, and around 100% for junior tranches with lower ratings. It is quite impossible to justify a charge for debt securities (with the liquidity and diversification they can provide) so far exceeding not only the charges for the underlying loans, but also the charge for investment in the asset or the borrower.

Finally, we do not feel that the requirement under Solvency II for long-term assets such as CRE to be 'marked to market' on a regular basis for reporting purposes is conducive to a long-term investment approach.

A regulatory system that wrongly calibrates the risks of investing in particular types of asset is unlikely to deliver the best outcome in terms of capital allocation. By making CRE (and securitised CRE debt) unnecessarily expensive in capital terms, Solvency II erects barriers to investment in the EU's built environment and makes it more difficult for institutional investors to channel money towards the provision of social and urban infrastructure. While much attention is being given to developing a solvency capital charge for infrastructure under Solvency II that does not create disincentives to invest in it, very little attention seems to be paid to the need to re-calibrate the capital charges for CRE and securitised CRE debt on a basis that is sensible in relative terms and based on appropriate data. This is a step that is urgently needed.

We are concerned that there seems to be very little appreciation of the detrimental impact that a flawed regulatory framework can have on the wider economy. We strongly encourage the Commission to review the capital requirements of Solvency II to address that problem.

Funding CRE – a poorly understood issue with important implications for the economy and financial stability

CRE is a capital-intensive business in which supply and demand are difficult to match precisely. New buildings take years to deliver, often only after a complex and costly process to secure planning permission. Even the changes in ownership that often unlock enhancement expenditure and investment in existing buildings take time and have high frictional costs (compared, for example, to transactions in financial instruments). These features of CRE mean that there is considerable risk involved in almost any decision, with complex feedback loops with broader economic conditions and demand both from investors in the capital markets and from the occupier market.

In most cases, CRE transactions (and especially CRE construction and development activity) must be funded through a combination of equity and debt in order to be viable. In most cases, equity alone is generally too expensive. The relationship between the property cycle and the credit cycle is, however, a difficult one, with mutually reinforcing feedback loops increasing the amplitude of the cycle and thus both the profits that can be made on the way up, and the losses that can be suffered on the way down.

Europe's banks continue to suffer the consequences of imprudent CRE lending (as well as other forms of lending) during the pre-crisis boom. However, policymakers have not yet conducted any strategic or holistic review of the economic value or the financial stability implications of the relationship between CRE and credit supply, and how it might be improved.

Fortunately, the industry has done so – we refer you again to "A Vision for Real Estate Finance in the UK", an independent industry report published in May 2014 which, despite its UK focus, also has much to offer other countries and the EU. The report, which is uploaded with this response, makes a number of recommendations for improving financial system resilience in the face of the property cycle while promoting a sustainable flow of credit to the CRE industry across the cycle.

Above all, the Commission should seek to promote two particular qualities in the CRE finance market to protect financial stability while maximising the ability of the CRE industry to serve the economy:

- Transparency. The CRE finance market is mostly private (which is not a problem) and opaque (which is). Better data is critically important both to allow market participants and investors to assess risks and returns, and to allow regulators to oversee the market and assess the effectiveness of applicable regulatory frameworks. Historically, the best source of information about CRE finance markets has been securitised CRE debt (CMBS). Unfortunately, Europe's regulatory response to the crisis is raising enormous barriers to the recovery of that public segment of the CRE finance market (see discussion of Solvency II above). That is in stark contrast to regulatory policy in the United States, where CMBS has recovered strongly since the crisis.

- Diversity. CMBS also has a vital role to play (alongside investment funds providing market-based finance) in dispersing CRE risk around the financial system and transferring exposures from the banking system to institutions and other investors. No-one should be surprised that a CRE finance market dominated by banks that are subject to the same set of regulatory incentives is vulnerable to the property cycle. Resilience would be enhanced with greater structural diversity of supply, with market participants pursuing different strategies over different time-scales, with a broader range of products available to borrowers in the CRE industry. There is a great opportunity for CMU (including through the initiative for promoting simple, transparent and standardised securitisation) to help deliver this.

Better transparency and diversity would complement greater insight and understanding among both market participants and regulators. We would expect the industry to respond to regulatory encouragement by developing standards and best practice, promoting consistency and quality in lending terms, risk assessment and pricing. That would in turn facilitate the aggregation of CRE loans, particularly to SMEs (through securitisation, syndication and otherwise), unlocking access to institutional capital.

For these benefits to be realised, policymakers need to adopt the strategic and holistic perspective of "A Vision for Real Estate Finance in the UK". To date, regulatory responses have been pursued in separate silos, always regarding CRE debt with suspicion. The consequences of that approach include a Solvency II capital framework that effectively makes CMBS unappealing to one of its most natural classes of investor, European insurers.

More generally on securitisation, we welcome the principle behind efforts to rehabilitate securitisation and revive securitisation markets. However, the policy goals of that initiative need to be met in the context of CRE and CRE debt markets – and that will not happen if the criteria for "simple, transparent and standardised" securitisation take a form that effectively excludes securitised CRE debt altogether. It is vital that regulators begin to see CMBS as an essential and valuable part of the CRE debt market (providing transparency and liquidity that is rare in the rest of that market), and not simply as a securitisation asset class that performed less well than other securitisation asset classes.

We urge the Commission to engage with our industry, which has demonstrated, through "A Vision for Real Estate Finance in the UK" and other initiatives, its ability to think self-critically, holistically and strategically about how the CRE debt market can be made safer from a financial stability point of view and more effective as a source of finance for the CRE industry across the cycle.

The SME finance conundrum

While there are steps that can and should be taken in order to improve SMEs' access to finance, it must be recognised that for very valid commercial reasons they are unlikely to ever be able to procure finance as easily or as cheaply as larger businesses. SMEs are by their very nature a riskier investment proposition than large, well established firms and one should therefore expect potential investors (both equity and debt) to require a higher return to compensate them for that risk.

For every success story and for every high-growth company there are hundreds of others that failed or will never grow large. Some SMEs are innovative, dynamic success stories of the future - but it is very difficult to identify them when they are start-ups. Prudence should be the order of the day when investing in or lending to such businesses. Trying to get to the position where – in the words of the Green Paper – "SMEs can raise financing as easily as large companies" is over-ambitious and perhaps even irresponsible, because the suggestion that the savings of European citizens should be channeled to a greater extent into such businesses could put savers at greater risk of financial loss. What is important is that those making investment decisions (whether as intermediaries or on their own account) can, and are encouraged to, assess risks and returns properly. That is the best way to strike an appropriate balance between the interests of businesses seeking capital and investors seeking returns.

6. Should measures be taken to promote greater liquidity in corporate bond markets, such as standardisation? If so, which measures are needed and can these be achieved by the market, or is regulatory action required?

No response.

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

No response.

8. Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

No. We understand the concern of adding additional costs to SMEs, and are in favour of avoiding that. Adhering to international standards will in the end benefit SMEs in a cross-border world that goes beyond Europe, but developing EU-specific accounting standards runs the risk of creating a framework that is incompatible and incomparable with other standards.

We would therefore advise the Commission to continue its engagement with the IFRS Foundation and the IASB to discuss what European SMEs need and how this can be incorporated in the existing global framework.

9. Are there barriers to the development of appropriately regulated crowdfunding or peer to peer platforms including on a cross border basis? If so, how should they be addressed?

No response.

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

Investment in start ups

While we agree that institutional investors should hold diverse portfolios in order to minimise investment concentration risk, we are concerned at the suggestion that they should be compelled to allocate money to certain sectors of the economy. Institutional investors are often the guardians of European households' savings and their primary objective should be to act in the best financial interests of those households rather than as providers of finance to businesses that policymakers might wish to see better funded.

This is particularly the case where providing such finance involves a significant degree of risk, as will inevitably be the case in the context of innovative start-ups. As we have mentioned already, the overwhelming majority of new businesses never become large and many fail altogether. Allocating a greater portion of household savings to funding such businesses could be detrimental for individual savers; and there is no guarantee that providing more capital to "SMEs" would benefit the economy because of the difficulty of identifying the start-ups that will become superstars.

Instead, the best way to incentivise investors (including institutional investors) is to ensure that regulation (a) promotes transparency and (b) avoids distorting economic risks and returns. Unfortunately, certain elements of post-crisis EU regulation have erred too far in seeking to disincentivise particular investments - the treatment of CMBS bonds under Solvency II, discussed above, is the most egregious example of this.

Investment in infrastructure

As noted in our response to question 5, the line between infrastructure and commercial real estate (CRE) is very hard to draw in a sensible way. Both are intrinsically long-term assets whose development takes considerable planning and effort and therefore deserve a supportive regulatory environment. That is not currently the case for CRE investment, particularly under Solvency II. As it stands, this regulation discourages investment in our built environment, including in the long-term, transformative projects that most benefit our towns and cities and drive the creation of construction sector jobs.

Infrastructure - finance vs. funding

It is widely accepted that Europe needs significant infrastructure investment in order to maintain its competitiveness. There has been significant debate over the past few years as to how additional private capital can be encouraged to invest in infrastructure and certainly greater transparency and clarity regarding infrastructure pipelines is essential to attract private capital.

However, what is often missing from the infrastructure debate - and does not appear to be properly considered in the Green Paper - is the difference between infrastructure funding and finance. Funding refers to how the cost of a piece of infrastructure is ultimately borne - and generally that is either its users (as in the case of toll roads, broadband and most utilities) or the taxpayer (such as for state-funded health and education systems). Finance refers to how the timing gap is bridged between expenditure (normally required upfront) and revenue (that starts flowing only once the project is complete).

In other words, finance provides the means to build infrastructure, but it cannot help if the funding is absent. Financing infrastructure is often complex, with pricing dependent on the cost of capital and risk allocation - but there are a variety of different mechanisms through which it can be achieved and an appropriate solution can generally be found for most projects. The impact of the financial crisis on the public finances of most European countries means that there is a growing reliance on private finance (which is in most cases more expensive than public finance because of the higher cost of capital of private sector organisations). Affordable investment can best be unlocked if the public sector is able to use its cheaper cost of capital, or to de-risk projects so that private finance becomes cheaper. Governments also need to be decisive in relation to ultimate funding decisions so there is clarity as to where the money will eventually come from to repay those financing infrastructure projects.

11. What steps could be taken to reduce the costs to fund managers of setting up and marketing

funds across the EU? What barriers are there to funds benefiting from economies of scale?
The Green Paper correctly identifies differences in Member State approaches to fund and fund manager authorisation as barriers to greater cross-border fundraising. Another barrier is the differing approaches that Member States take to what constitutes 'marketing' of a fund and whether permission is required to carry out such activities. Uncertainty and inconsistency in this area discourage fundraising by introducing regulatory risk and increasing costs. However, perhaps the greatest concern for prospective fundraisers is the AIFM Directive itself. While it provides for the first time a (broadly) single set of rules for fund managers across the EU, it also introduces demanding and costly compliance requirements. We have heard reports of fund managers planning to merge or close funds as the costs of compliance for individual products become too much for investors to bear. Perhaps more worryingly, the AIFMD introduces substantial fixed costs for fund managers that disproportionately affect smaller firms. The requirements of the AIFMD have become a barrier to entry, entrenching the position of the largest firms – that are able to afford well-staffed compliance departments – and stifling innovation by and competition from new challengers. While any new piece of regulation is likely to have teething issues, we would encourage the Commission to keep a close eye on developments in the fund management world to assess whether the AIFMD has led to any consolidation or reduction in competition in the sector.
12. Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets?
No response.
12.1 If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?
As we have already mentioned, the commercial real estate (CRE) industry plays a critical role in delivering the urban infrastructure that makes cities desirable places to live and work. We would recommend that changes be made to the regulatory treatment of CRE (especially securitised CRE debt or CMBS) in order to allow it better fulfil its potential in supporting the rest of the economy.
13. Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?
No response.
14. Would changes to the EuVECA and EuSEF Regulations make it easier for larger EU fund managers to run these types of funds?
No response.
14.1 What other changes if any should be made to increase the number of these types of fund?
No response.
15. How can the EU further develop private equity and venture capital as an alternative source of finance for the economy?
No response.

15.1 In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

No response.

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

We refer you to our response to question 5 above and again highlight the recommendations made by "A Vision for Real Estate Finance in the UK" regarding steps that could be taken to increase the diversity of sources of debt finance from the point of view of the commercial real estate (CRE) sector, and also to better insulate banks from the cyclicality of CRE markets. While the report is focused on UK CRE, many of the themes and issues it explores have application more generally across different parts of the economy, and for markets beyond the UK.

Among other things, the report recommends better availability of credit data, greater standardisation of loan terms and a regulatory environment that is both structurally counter-cyclical and supportive of diversity and the emergence of lenders that specialise in particular types of lending or lending to particular sectors.

Regulation that poorly reflects the real risks of investing in different types of debt instrument (including CRE debt and CMBS) actively works against the objective of increasing both bank and non-bank financing to businesses.

17. How can cross border retail participation in UCITS be increased?

No response.

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

No response.

19. What policy measures could increase retail investment?

No response.

19.1 What else could be done to empower and protect EU citizens accessing capital markets?

No response.

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

No response.

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

Oversight of financial regulation

Over the past five years, financial services regulation has become increasingly complex and prescriptive, with rulebooks running to thousands of pages that most businesses - and even regulators - currently struggle to really understand. Familiarity with the new regulatory landscape should increase over time, but the sheer volume of the legislation that now applies to the financial

sector means that there is nobody who truly understands how it all fits together. Less would almost inevitably be more, from the point of view of the quality of regulation. In our view, the lack of effective holistic and strategic oversight poses a significant risk. Post-crisis regulatory initiatives were largely developed in silos, each with a particular objective, and the impact of each was assessed on a stand-alone basis. There has been little consideration of the cumulative impact of e.g. AIFMD, EMIR, Solvency II, CRD IV on critical economic sectors and the implications for European growth, job creation and financial stability. This message emerged strongly in responses to a consultation of the Economic Affairs Committee of the European Parliament on enhancing the coherence of EU financial services legislation. We would also support a number of the other themes that emerged during that consultation, in particular the need for more realistic time frames for developing regulation (taking into account the time needed to prepare Level 2 measures). We would also encourage a far higher priority on ensuring mutual recognition and sensible territorial boundaries between different regulatory regimes around the world, especially between the EU and the US. Capital is global, so harmonisation of regulation within the EU (even if it were perfect) is not enough. The combination of very broad brush high level policy making and very complex detailed regulation developed in silos has meant that a critically important industry sector like commercial real estate (CRE) has been overlooked and sidelined, to the detriment both of the industry and of the economy and financial stability.
22. What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?
A greater focus on ensuring mutual recognition and sensible territorial boundaries between different regulatory regimes around the world, especially between the EU and the US would be helpful.
23. Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?
No response.
24. In your view, are there areas where the single rulebook remains insufficiently developed?
No response.
25. Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a Capital Markets Union?
No response.
26. Taking into account past experience, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets within the EU?
No response.
27. What measures could be taken to improve the cross-border flow of collateral?
No response.
27.1 Should work be undertaken to improve the legal enforceability of collateral and close-out

netting arrangements cross-border?
No response.
28. What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?
No response.
29. What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?
The very different insolvency and enforcement regimes facing lenders and debt investors across the EU can present real challenges, limiting the effectiveness of the single market in the financial sector. Lenders and debt investors often have to accept significant structuring costs or legal uncertainty when they seek to minimise the constraints imposed on them by slow, cumbersome or simply very borrower-friendly regimes in some (mostly southern European) countries. That, and the fact that some countries only allow commercial real estate (CRE) lending by entities holding a banking licence in their jurisdiction, are the two major impediments to the emergence of a pan-European loan capital market, in our view. It is worth noting that some of the countries worst affected by those impediments are also facing the biggest challenges with their domestic banking systems (Italy and Greece, for example).
30. What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?
Through its base erosion and profit shifting (BEPS) initiative, the OECD is currently reviewing the international system of taxation to identify how aggressive cross-border tax avoidance can be curtailed. While the intention behind these efforts is laudable, some of the proposals tabled by the OECD have the potential to considerably disrupt international investment. We would encourage the Commission to take an interest in these developments and critically challenge them where they pose a risk to multinational trade and investment that Europe needs. We set out two particular concerns below. Double tax treaties In order to encourage greater flows of capital across Member States it is very important that cross border investment is not penalised through the tax system. This is particularly true for collective investment undertakings (CIUs), where the aim should be for ultimate investors to suffer no more tax than if they had invested in the underlying assets directly while at the same time benefiting from the economies of scale and professional management provided by collective investment. In this context, the ability to access double tax treaties (DTTs) is crucial as otherwise an investment may suffer multiple layers of taxation, rendering it economically unviable. Action 6 of the OECD's BEPS plan is to review whether access to DTTs should be restricted in order to prevent their being used in order for egregious tax avoidance. This is good, but the proposals currently on the table could result in CIUs not being able to claim the benefits of DTTs. The way the 'limitation on benefits' and 'derivative benefits' clauses are currently drafted is particularly problematic, as they would deny relief to 'alternative' investment funds (e.g. commercial real estate (CRE) or private equity) and entities within their investment structure.

If these proposals are not modified before being implemented the negative impact on cross-border investment through CIUs could be substantial. The commercial viability of multinational CRE and private equity investment structures would be jeopardised and the valuable contribution they make to both the real economy and to savers severely curtailed.

Tax treatment of debt compared to equity

Numerous commentators have suggested that the relative tax treatments of debt and equity could create distortions or perverse incentives in the way that businesses finance themselves. According to the OECD (Action 4 of the BEPS plan) it also gives rise to opportunities for profit shifting, and there appears to be an emerging narrative that the tax deductibility of debt finance should be generally restricted.

We suspect that too much prominence is being attributed to the deductibility of debt finance as a reason for its widespread use. In the CRE context, and probably across other sectors of the economy, there are powerful commercial reasons for using debt finance, including the following.

- Debt is vital to equity constrained investors. Debt finance opens up investment opportunities that would otherwise not be possible because of the high cost of equity (which bears higher risks and therefore requires higher returns than debt). This helps to drive economic growth.

- Debt allows for greater risk diversification. Borrowing money means you can afford to commit less equity to individual investments and can gain exposure to a greater range of investments. This reduces the vulnerability of portfolios and helps to smooth overall returns.

- Debt can be more flexible than equity. Borrowing arrangements can also be tailored to reflect individual circumstances and can be periodically renegotiated. The greater accessibility and flexibility of debt allows funding to be provided to investment opportunities more quickly which ultimately facilitates quicker economic growth.

- Debt can facilitate the repatriation of income to investors – many countries impose restrictions on the amount of equity capital that can be returned to investors in a particular time period. Intra-group lending arrangements make it easier to provide returns to investors, who may require these on a regular basis in order to meet their own liabilities as they arise.

Restricting the tax deductibility of debt finance is therefore unlikely to see a simple replacement of debt euros with equity euros - it is more likely to give rise to a reduction in overall investment volumes, particularly in higher risk and capital intensive parts of the economy (like CRE), many of which can be economically very valuable.

Restricting the deductibility of debt would pose an enormous transitional challenge for all businesses and over the longer term would disadvantage those industries that – by virtue of being inherently capital intensive or higher risk – are structurally reliant to a greater extent on debt finance. That would include infrastructure and CRE, and may well also include many up-and-coming SMEs. Accordingly, any proposals to change the tax treatment of debt finance need to be carefully thought out, the reasons for effecting the changes must be clear and it must be reasonably certain that the desired outcome could not be achieved through other means.

31. How can the EU best support the development by the market of new technologies and business models, to the benefit of integrated and efficient capital markets?

No response.

32. Are there other issues, not identified in this Green Paper, which in your view require action to

achieve a Capital Markets Union? If so, what are they and what form could such action take?
No response.