BPF

BRITISH PROPERTY FEDERATION

BPF response to Call for Evidence "Single Market: Financial Services and the Free Movement of Capital"

Introduction

The British Property Federation (**BPF**) is the voice of property in the UK, representing businesses owning, managing and investing in property. This includes a broad range of businesses, comprising commercial property developers and owners, financial institutions, corporate and local private landlords and those professions that support the industry, including law firms, surveyors and consultants.

In light of the Review of the EU's balance of competences in the field of financial services and the free movement of capital, we welcome this opportunity to comment on the topics raised by the consultation.

Background

The severity of the recent crisis exposed manifold vulnerabilities in the financial system arising as a result of poor regulation coupled with increasing complexity and risk appetite. Those characteristics made the financial sector extremely sensitive to a sudden fall in broader market confidence. When such a shift in confidence materialised, the financial services industry suffered huge losses, with significant repercussions on the real economy. The reaction of regulators - to swiftly impose corrective measures to mitigate the chances and severity of future crises – is entirely understandable, although arguably those measures were introduced at precisely the wrong time in the economic cycle.

We do not disagree with the need to correct any imbalances and misbehaviours embedded in the system or with the need for a sensible regulatory framework at the European level to address the risks arising from the increasing interconnectedness and complexity of the financial sector. However, we would stress that many financial and investment businesses were hit very hard by the crisis and continue to operate in a challenging economic environment. Imposing on them the high costs of additional regulation and compliance in a context of continuing uncertainty may have deleterious effects on the health and diversity of the financial sector and by extension the real economy which relies upon it.

We therefore wish to highlight the dangers of introducing new financial regulation without a proper analysis and understanding of the wider effects of such regulation on the real economy. The interaction of the financial services industry with the real economy is highly complex and a comprehensive assessment should be required of all proposed regulatory measures to ensure that the potential implications for the real economy have been properly understood.

We agree with the Review's comments that the way in which some European bodies have been able to sidestep the all-important impact analysis of the measures they were about to introduce is a source of concern. We would also like to add that regulators should be aware of the risk of implementing legislation in a way that mirrors and amplifies the economic cycle. It is during cycle upturns that regulation should be reinforced to mitigate the intensity of bubbles. Likewise, it is during cycle downturns - when the sources of finance are constrained - that regulation should be softened so as to support real economy businesses.

Key points

In light of the above, we would like to make the following points:

- **Question 3:** Some EU rules are likely to have a detrimental effect on competition. For instance, the Alternative Investment Fund Managers' Directive (AIFMD) will introduce a number of compliance and capital requirements which apply to funds with relatively low levels of assets under management.

  It is expected that these requirements will make it uneconomical to operate funds of under a certain size, raising barriers to entry which restrict the amount of competition and choice in the market. They will also inhibit the emergence of new and innovative managers (the SME part of the fund management sector) as only large investment houses will have the financial and technical wherewithal to navigate the new regime.

  By way of further example, the European Market Infrastructure Regulation (EMIR) will impose central clearing requirements on OTC derivatives on all financial entities, not recognising that some of them (for instance real estate funds) overwhelmingly use derivatives for commercial hedging purposes. EMIR could make traditional hedging (carried out for prudent business reasons) unviable for some investment funds, forcing them to either accept higher levels of risk or to hedge less efficiently. That would again have a negative impact on competition and healthy market development.

- **Question 4:** We believe that the high volume of financial regulation introduced over the last few years has been a knee-jerk reaction (albeit an understandable one) to the crisis at a time when the economy would have benefited instead from more stimulus in order to soften the blow for the real economy. Regulation should be countercyclical, with measures that apply in such a way as to prevent the economy from overheating in periods of growth and to avoid stifling businesses in periods of stress.

  We certainly do not consider that the pace of creation of new EU financial regulation over the past five years is sustainable or desirable. We would like to see a period of 'bedding in' and assessment of the new regulatory regime before any further change is considered.

- **Question 9:** EU consultations should give businesses the opportunity to help policy makers see things from their perspective. Whilst on our experience due process is generally followed, the success and effectiveness of that process is regularly sabotaged by the high level of staff turnover within EU institutions.

  This lack of consistency of personnel makes it practically impossible to establish long-term constructive relationships with officials, prevents the buildup of institutional knowledge and results in officials having a poor understanding of how

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different parts of the financial sector (let alone the real economy) fit together. Without such knowledge and understanding of the 'bigger picture' the result is regulation which is not well-tailored to those to whom it is intended to apply and which does not support the real economy.

- **Question 10:** The State Aid rules have arguably hampered the UK's economic recovery by restricting the extent to which the Government can support the national economy.

  To take a very real estate specific instance, the government recently introduced an exemption from empty property rates for owners of newly built property. The policy objective of that measure was to reduce the cost and risk faced by speculative commercial property developers (e.g. those interested in the distribution and data centres which support the digital economy) of not being able to immediately find an occupier for their building. Sadly, the State Aid cap will severely curtail the measure's effectiveness, as the support which government can offer is desultory in the context of most property developments.

  Another example would be the inability of the UK to introduce any sort of tax relief for capital expenditure on new buildings (along the lines of the old Industrial Buildings Allowances) due to State Aid concerns. At a time when such a relief would have been a boon to the construction and infrastructure sectors (by making it a more attractive investment proposition) the government was hamstrung in what it could offer.

  Notwithstanding the above, it may be that it is the UK's interpretation of State Aid (rather than the rules themselves) which may be the real issue. There is ample anecdotal evidence that the UK is far more stringent in its interpretation of the State Aid rules than other EU member states. Whilst we would not advocate for any intentional breach of the rules, we do wonder whether there is any scope in revisiting the application of the State Aid rules in a UK context.

We remain at your disposal should you wish to discuss in more detail any of the comments in this response.

Ion Fletcher