afep

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# GREEN PAPER – BUILDING A CAPITAL MARKETS UNION

## EXECUTIVE SUMMARY OF OUR KEY MESSAGES AND EXPECTATIONS

In the aftermath of the crisis and in the context of the ECB quantitative easing measures, financial resources currently now are available for investment at European Union (EU) level. The question arising is how best these resources can meet the financing needs of companies, which are considerable.

We support the EC's objectives of developing capital markets and of strengthening funding channels. However, several **major elements should be taken into account**:

— **Hedging and liquidity needs should be addressed**: the Green Paper rightly focuses on access to finance, but like current legislative proposals – on a Financial Transaction Tax (FTT) and on the Banking Structural Reform (BSR) –, does not take into consideration the **needs of corporates** to **hedge** their operating and financial risks through derivatives – including OTC derivatives - **and** to have enough **liquidity** for their shares and bonds;

— Private investors are expected to provide the bulk of financing (including through the European investment plan). The **decisions to invest** private funds in the EU are **based primarily on favorable macro and micro-economic prospects**, compared to other geographical areas, **not upon further regulation**[1] **or additional mandatory reporting requirements**. Reducing public expenditure and debt remains a *sine qua non*, in particular as they divert a very significant portion of the financial resources from the financing of the real economy;

— It is **appropriate to develop certain financing channels or instruments**, as possible supplements to bank direct lending (respectively: securitisation, institutional investors, including insurance companies and pension funds; private placements, European Long-Term Investment Funds / ELTIFs, a standardised personal pension product…). **However** this will take time and therefore **this is not sufficient** to meet the considerable financing needs of non-financial companies. **Banks, insurance companies and pension funds still have a major role to play in direct lending/financing** (including through ELTIFs and private placements) **and in ensuring the liquidity of the corporate shares and bonds issued; asset managers, in managing investments**;

— In order to maximise the benefits of investments for the EU, it is **necessary to target productive investments in the following areas: innovation, from companies of all sizes**[2]**; long-term investments**[3] **(including through equity funding); SMEs as well as mid-sized companies**. In order to consolidate companies' capacities and to reduce the equity gap, it is essential to **avoid increasing companies' tax burden – notably through the introduction of a European Financial Transaction Tax (FTT) – and not to require companies sponsoring occupational pension funds to bolster their capital in accordance with requirements that would be inspired by the Solvency II Directive (in the context of the revision of the Directive on** Institutions for Occupational Retirement Provision / **IORP)**;

— In order to facilitate the identification and assessment of financing needs **at EU level**, it is necessary to **consider extending a central EU-level website** to include infrastructure, as well as other types of, key projects **and to develop management and monitoring tools**, including transparent resource allocation processes and statistical tools;

[1] Except for the legislative measures needed in limited cases; please see below.
[2] Not only start-ups.
[3] Not only infrastructure investments, but also support for the economic and industrial structural changes, for example: implementation of new technologies; support of technological and industrial change; support of the energy and ecological transition.

— The CMU initiative should **not delay the implementation of the European investment plan** ("Juncker plan") **and the measures aimed at supporting long-term investments**;

— We have not identified major obstacles to cross-border investment that would necessitate other than targeted measures. In our view the **central issue** to address is **how to incentivise investments, and attract and retain investors for these targets. As a priority, the following policy measures should be taken in the short-term** to ensure their profitability: **more favourable tax treatments for companies and investors**[4]**; better risk-sharing; exit opportunities and a better regulatory treatment for long-term investments; better calibration of Basel III and Solvency II prudential requirements; improved post-trade market transparency**;

— With the possible exception of securitized products, which is being considered separately, **reporting requirements on businesses are sufficiently developed to ensure proper investor and consumer protection**. They are such that they increase excessively the cost of raising capital and constitute a major obstacle to accessing markets. **On the contrary,** reporting requirements **should be alleviated** (e.g. non-financial institutions'reporting obligations under EMIR; requirements under the Prospectus legislation), **rather than extended (**in particular companies'**non-financial reporting obligations**[5]; single **electronic reporting format / ESEF, that would be based on a "built-in" or "integrated" approach**[6]);

— The single rulebook is sufficiently developed: **new legislative measures** should be taken **only to incentivise investments and to ease corporates' reporting requirements, along the lines mentioned above. Apart** from these cases, it should be **up to the market to provide solutions/guidelines**, eg as regards standardisation of corporate debt issuances and markets, including for green bonds. A regulatory intervention could inhibit the development of such financial instruments and markets and should thus be avoided;

— **After improving the European** regulatory, fiscal and prudential **framework**, it is key to **ensure its stability**, for companies and investors alike;

— **While supporting the objective to attract investment from third countries on European markets, we believe that the EC should also ensure that EU-based companies can benefit from ready and cost-effective access to third-country markets and local investors;**

— The **European Supervisory Authorities (ESAs)**, as technical advisors to the EC, are currently preparing many draft delegated acts and regulatory and implementing technical standards for adoption by the EC, which correspond to the numerous level 1 texts adopted in the previous legislature[7]. The **powers of ESAs** are **sufficient to play an important role** in that capacity and in ensuring **consistent implementation and application of EU law across the EU**. Their action should **now focus on organising and monitoring control methods and programs at EU level to ensure a level playing field between the undertakings concerned**, with the **implementation** of controls remaining within the **remit of national supervisory authorities**[8].

[4] As regards corporate income tax and the tax treatment of savings.
[5] A Directive on Non-financial information has recently been adopted by the Council and the European Parliament.
[6] ESMA was assigned by the EC to prepare by 2016 the technical standards corresponding to a single electronic reporting format. Using a "built-in" or "integrated" approach or structured formats – such as XBRL or Inline XBRL - would lead to make significant and costly changes upstream throughout companies' processes and information technology systems, without improving the quality and comparability of their publications.
[7] In total, around 400 delegated acts are expected.
[8] With the exception of banks that are supervised directly by the ECB.

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**About Afep**

The purpose of **Afep**, the **French Association of Large Companies**, is to present their views to the European Institutions and the French authorities, mainly with regard to non-sectoral legislation (on the economy, finance, financial information and markets, taxation, company law, competition, intellectual property rights, consumer affairs, social protection, employment legislation, environment and energy, corporate social responsibility, etc.).

Afep represents 113 top private sector companies operating in France. Afep member companies employ more than 2 million people in France and 8,5 million people worldwide. Their annual combined turnover amounts to €650 billion in France and €2,600 billion worldwide.

As a major force for analysis and proposals, Afep is also a prime forum for contacts between member companies and public authorities, which consult the Association when considering policy directions, plans for reforms or legislation. Senior officials in the European Union and French administrations regularly take part in meetings organised at the head office of the Association, enabling direct and constructive dialogue to take place.

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**SUMMARY OF OUR VIEWS, KEY MESSAGES AND EXPECTATIONS**

**Our views, key messages and expectations can be classified under the following headings:**

**1. The European Commission's consultations, steps in the right direction;**

**2. Our key messages and expectations**

**2.1. Our views regarding key political orientations**

**2.2. Key expectations: issues requiring further policy attention and action**

**2.3. Key expectations regarding the nature and timing of the measures expected.**

These are considered below.

## 1. THE EUROPEAN COMMISSION'S CONSULTATIONS, STEPS IN THE RIGHT DIRECTION

The Green Paper of February 2015 on the Capital Markets Union (CMU) constitutes an opportunity for the European Union (EU) to shape a forward-looking approach to strategic challenges. Member companies **welcome** the European Commission (EC)'s initiative of starting a broad debate on the financing of the economy, in particular:

- the search for a **balance between reducing risks and stimulating growth**, based in particular on the idea that a lack of growth may represent a threat to financial stability;
- after years of crisis and a reduction of investment reaching 15% since 2007, the key place given in the EC's work programme to **investment in Europe's companies and infrastructure, as a stimulus for jobs and growth**; the aim to strengthen investment for the **long term**, by the € 315 bn European investment plan and by other measures; the first efforts undertaken to **identify** long-term **projects** for priority funding;
- the CMU **Green Paper's objectives** of: increasing and diversifying the sources of funding ; reducing the cost of raising capital for all businesses and the costs of investing;
- the **idea that past legislative measures can be considered** to ensure that they are well calibrated and consistent;
- the fact that **options other than legislation** are **also considered**;
- **some other initiatives** taken:
    - the review of the Prospectus Directive to make it easier for companies to raise funding, as a short term priority;
    - the development of proposals at European level to encourage high quality securitisation in the short-term and free up bank balance sheets to lend;
    - the consideration of work to identify infrastructure investments that could benefit from a tailored prudential treatment.

## 2. OUR KEY MESSAGES AND EXPECTATIONS

### 2.1. OUR VIEWS REGARDING KEY POLITICAL ORIENTATIONS

At a macro-level, member companies wish to **underline** the following:

- **Enhancing investor confidence relies heavily upon positive macro and micro-economic prospects, not upon further regulation or additional transparency requirements on businesses**. As a **prerequisite**, public authorities have the task of bringing the economy back to a dynamic of sustainable growth. This involves in particular **restoring sound economic fundamentals to generate savings and to attract and retain liquidity**. The EU and its non-financial companies will become more attractive to investors if the **public finances** are **consolidated** and if **companies' competitiveness and self-financing capacity** are **restored**:
  . **reducing public expenditure and debt is a *sine qua non***: indeed, public debt penalises growth, employment and consumption, increases risk and public and private sector borrowing rates, diverts from the EU resources coming from other countries, or **captures a very significant portion of the financing, particularly at long term, to the detriment of financing of the economy**;
  . **corporate self-financing** is the **necessary starting point for a virtuous circle of financing and investment**: maintaining companies' self-financing capacity at a high level enables them to reduce the equity gap, to keep control of innovative activities and to make full use of external financing to finance investments, in particular long-term investments.
- It is key, not only to attract more investment into the EU from the rest of the world and increase competitiveness, but also to **promote the emergence of European companies with a global dimension and** to **encourage innovation from companies of all sizes** (innovation is not only achieved by start-ups);
- **Europe's financing requirements** for the coming years **are considerable**[9] and make **access to financing an absolute priority** for the European Union (EU), in a context of increasing global competition, not only in the field of **innovation** and talent, but also as regards access to energy, raw materials and financing. **Financial resources** are **needed, in particular to face a structural shortage of long-term financing**. **Long-term saving should be encouraged to respond to this need and to the European demographic challenge**;
- **One of the obstacles to boosting long-term financial resources** and to the development of EU capital markets – in particular by contrast to the US – results from the **characteristics of pension provision.** Long-term saving, pension schemes and products should be encouraged: they constitute responses to the European demographic challenge and to the need to find such resources to meet the needs of the real economy;
- It is **appropriate to develop certain financing channels or instruments** (respectively: securitisation, institutional investors, including insurance companies and pension funds; private placements, ELTIFs, a standardised personal pension product…) and to increase and diversify the

[9] According to a study by Standard & Poor's published in May 2013, the financing needs of non-financial companies in the euro zone were estimated at $8.3 to $8.56 trillion for the period 2013-2017 alone.

sources of funding (institutional, retail and international investors). **However** the CMU **Green Paper contains only few elements on how to attract and retain investors**, which is a **<u>central issue</u>**. Therefore, **<u>as a priority, policy measures should be taken to incentivise investments and ensure their profitability</u>** (please see § 2.2 below);

- **In contrast, we have <u>not identified major obstacles to cross-border investment</u> within the EU and from third-country investors, at least as regards large companies**;
- While fully appreciating that the recent reforms are aimed at achieving financial stability, we must also take account of their contrasting effects on the financing system as a whole, and therefore on the real economy. **<u>We do not support the development of new legislative measures, apart from limited exceptions</u>** (please see § 2.3 below);
- **We are deeply concerned by <u>two ongoing legislative proposals</u> – on the Financial Transactions Tax (<u>FTT</u>) <u>and</u> the Banking Structural Reform (<u>BSR</u>)** -, which **<u>contradict the objectives of the CMU</u> Green Paper and the provisions of the European Market Infrastructure Regulation (EMIR).** The common feature of these proposals is that they **do not take into account the needs of corporates** to **hedge** their operating and financial risks through derivatives – including OTC derivatives - **and** to have enough **liquidity** for the shares and bonds they issue:
  - while Europe needs to attract capital and investments, the FTT would harm investors and companies and, where they are established in the taxation area, put them at a competitive disadvantage;
  - the BSR would negatively affect non-financial companies'ability to carry out financing and hedging activities in an appropriate and cost-effective manner and would not preserve the banking activities and services relevant to corporates, such as market-making and underwriting activities with a connection to actual or anticipated client activity.
- <u>In relation to **securitisation**</u>, **different <u>issues</u> need <u>to be addressed</u>**:
  - given the wide diversity of companies, in particular SMEs and mid-sized companies, there is a challenge for identifying homogeneous classes of related assets for the purpose of securitisation, if it is to substantially contribute to the financing of businesses;
  - when defining simple, transparent and high quality securitisation:
    - the **traceability** of securitised assets and issued securities should be ensured, to maintain financial stability and avoid exposing investments (from corporates and others) to excessive risks;
    - a key question to consider is the **extent to, and the conditions under, which security holders may benefit from a guarantee** (this feature is a key driver of the US securitisation market) **or from refinancing operations with the European Central Bank (ECB)**;
    - the take up of securitisation will take time and the effects on the financing of companies are uncertain. It is thus essential to **recognise the central role of banks in direct lending/financing;**
    - in order to **get consistent definitions of High Quality Securitisation (HQS) globally,** it would be useful to refer to **the work carried out in this area by IOSCO** (November 2012 and December 2014 reports).

## 2.2. KEY EXPECTATIONS: ISSUES REQUIRING FURTHER POLICY ATTENTION AND ACTION

- **Scope of the funding issues**: the CMU Green Paper focuses on investors (certain aspects) and intermediaries. However it should **target explicitly as a priority: long-term investments (including through equity funding); innovation from companies of all sizes; mid-sized companies and SMEs**.
  - the Green Paper does not specify how it articulates with the 2014 EC **Communication on Long-Term Financing, although long-term financing remains a priority**. The CMU initiative should **not delay measures aimed at supporting long-term investments and the implementation of the European investment plan** ("Juncker plan");
  - . it does not sufficiently emphasize the important role of companies in capital markets and their need for **equity** funding;
  - . it fails to recognize that the funding of **innovation** should be supported for businesses of all sizes (not only for start-ups);
  - . it rightly seeks to improve access to finance, notably for SMEs, but in some respects does not sufficiently take into account the role of **mid-sized companies**[10], which are key to the development of capital markets and to the emergence of European companies with a global dimension.
- **Hedging and liquidity**: the CMU Green Paper focuses on financing and does not sufficiently address the **need of corporates to hedge their** operating and financial **risks** and the **need to ensure greater liquidity in markets**:
  - . to manage their risks, corporates need in particular to enter into **derivative contracts** – over-the-counter or not – **at limited cost**;
  - . it is necessary to foster the growth and the liquidity of **secondary markets** and thus not to penalize the **market-making activities**[11] **and** the **liquidity contracts** aimed to ensure the liquidity of the securities issued by corporates (shares as well as bonds).
- **Investment incentives**: to meet the objectives of the CMU Green Paper, **policy measures should be taken to incentivise investments in productive, strategic or innovative projects and to ensure their profitability**, taking into consideration their risks and time horizons. **Five drivers need to be considered in the short-term**:
  - . **more favorable tax treatments** (corporate income tax and taxation of savings income): the need to make progress is **more pressing than ever**. The tax treatments associated to financing and savings/investment should foster longer duration, more risky and/or less liquid investment into corporate shares and bonds, as well as related funds (including ELTIFs). It seems particularly advisable to **coordinate tax policies and issue EU recommendations**, in order to achieve this objective at EU level;

[10] Companies with less than 5 000 employees and either a turnover of more than € 50 million and not exceeding € 1 500 million and/or an annual balance sheet total not exceeding € 2 000 million.

[11] At the same time taking care to ensure that market-making activities are compatible with the markets'essential long-term financing function.

. **better <u>risk-sharing</u>**: it is advisable to consider mechanisms that would allow certain investments (e.g. long-term or innovative projects) to benefit from guarantees (credit enhancement, etc.);

. **<u>exit opportunities and better regulatory treatment</u> for long-term investments**: when developing financing instruments, such as ELTIFs, exit opportunities should be provided to investors. In any case, flexibility is needed to make investments, including long-term investments, more liquid and attractive;

. **an appropriate or better <u>calibration of prudential requirements</u>**: prudential requirements must be such that they are not unfavourable to banking intermediation and institutional investors[12] - , in particular insurance companies and pension funds, including occupational pension schemes - relative to short-term investors and unregulated players, particularly those from the shadow banking system (SBS)[13]. Otherwise, the general objective of stability would not be achieved and the long-term financing channels would be severely and lastingly affected. **Prudential requirements must encourage institutional investors** that pursue a long-term investment strategy **to invest long-term capital, in particular into infrastructures**.

. **ensuring <u>post-trade market transparency</u>**: it is essential that the new MiFID II provision to have a consolidated tape and that information be available at reasonable prices be carried through.

- **<u>Banking maturity transformation</u>**

  Given the scale of long-term financing requirements, the difficulty of funding them adequately with long-term resources and the time needed to develop securitisation, the transformation function is indispensable, in particular for SMEs and mid-sized companies. The major role of banks in this area must be preserved, notably in the context of the implementation of the long-term liquidity ratio (Net Stable Funding Ratio / NSFR)[14]. It is also important to make the short-term liquidity ratio (Liquidity Coverage Ratio / LCR) more flexible by including high-quality assets eligible for central banks[15].

- **<u>Information and resource allocation process</u>**

  A **proliferation of decision centres** may lead to projects that are strategic for the EU being financed too late or not at all. Therefore, it is indispensable to enable the identification and assessment of projects that are of key importance, as well as a possible identification of players, through dedicated **management and monitoring tools - including statistical ones -**. We support the creation of a **central EU-level website** to provide links to Member State projects/pipelines and include EU project information[16], and would welcome an **analysis** to assess the extent to which such website could be **extended to include other types of key projects**. More specifically:

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12 Prudential rules may inter alia lead to short-term investments replacing long-term ones due to excessive liquidity requirements.

13 Operators from the SBS are less regulated and more numerous . This would lead to the risk of financing channels becoming longer, more complex and more vulnerable.

14 Prudential rules should inter alia count statistically stable liabilities as long-term resources.

15 In the field of banking, it is particularly important to relax the short-term liquidity ratio by including high-quality assets eligible for central banks. This would be more in line with the US situation, where some 50% of mortgage loans currently are refinanced by companies supported by the government (Fannie Mae, Freddy Mac, etc.)

16 As suggested by the Investment Task Force Report of December 2014 (e.g. under the Connecting Europe Facility and European Structural and Investment Funds)

. It is necessary to have a **statistical measurement tool** at European level – eg under the auspices of Eurostat or the European Central Bank (ECB) - relating to **corporate financing** enabling a distinction to be made, in particular, according to the size of companies, to the types of financing needs and to the currencies attached;

. Companies should be provided with clear **information regarding the access to European funds**: many companies remain unaware of eligibility rules, what needs to be done to access European funds and which intermediaries to contact.

## 2.3. KEY EXPECTATIONS REGARDING THE NATURE AND TIMING OF THE MEASURES EXPECTED

- The single rulebook is sufficiently developed;
- We have not identified major obstacles to cross-border investment that would necessitate other than targeted measures. In our view the **central issue** to address is **how to attract and retain investors** for the following targets: innovation, from companies of all sizes[17]; long-term investments[18] (including through equity funding); SMEs as well as mid-sized companies. **As a priority, the following policy measures should be taken in the short-term** to incentivise investments in these areas and ensure their profitability: **more favourable tax treatments for companies and investors; better risk-sharing; exit opportunities for long-term investments; better calibration of Basel III and Solvency II prudential requirements; improved market post-trade transparency.**
- While fully appreciating that the recent reforms are aimed at achieving financial stability, we must also take account of their contrasting effects on the financing system as a whole, and therefore on the real economy. **We do not support the development of new legislative measures, apart from the following limited exceptions**, which aim **to incentivise investments and ease corporates'reporting requirements**:

  . **correction of inconsistencies in level 1 measures**, essentially as regards prudential requirements and ELTIFs, to give them more flexibility;

  . **development of level 2 measures** provided for by **adopted level 1 legislation**, **ensuring proper calibration of Basel III and Solvency II prudential requirements**;

  . **easing the reporting burden on businesses, through the review of the Prospectus Directive[19], a review of the European Market Infrastructure Regulation/EMIR or other measures.**
- **Apart** from these cases, it should be **up to the market to provide solutions/guidelines**, eg as regards standardisation of corporate debt issuances and markets, including for green bonds, or private placement markets. A regulatory intervention could inhibit the development of such financial instruments and markets – which we support - and should thus be avoided;

[17] Not only start-ups.

[18] Not only infrastructure investments, but also support for the economic and industrial structural changes, for example: implementation of new technologies; support of technological and industrial change; support of the energy and ecological transition.

[19] In particular, the content and status of the summary of the prospectus should remain unchanged.

- The **European Supervisory Authorities (ESAs)** are currently preparing many draft delegated acts for adoption by the EC, which correspond to the numerous level 1 texts adopted in the previous legislature[20]. The powers of ESAs are sufficient to play an important role in that capacity and in ensuring consistent implementation and application of EU law across the EU. Their **action should now focus on organising and monitoring control methods and programs at EU level to ensure a level playing field between the undertakings concerned**, with the **implementation** of controls remaining within the **remit of national supervisory authorities**[21];
- In order to ease the burden on businesses, the EC should not retain a single **electronic reporting format/ESEF, that would be based on a "built-in" or "integrated" approach**[22].

[20] In total, around 400 delegated acts are expected.
[21] With the exception of banks that are supervised directly by the ECB.
[22] ESMA was assigned by the EC to prepare by 2016 the technical standards corresponding to a single electronic reporting format. Using a "built-in" or "integrated" approach or structured formats – such as XBRL or Inline XBRL - would lead to make significant and costly changes upstream throughout companies' processes and information technology systems, without improving the quality and comparability of their publications.

**GREEN PAPER – BUILDING A CAPITAL MARKETS UNION**
**AFEP'S RESPONSE TO THE QUESTIONNAIRE**

***1) <u>Beyond the five priority areas identified for short term action, what other areas should be prioritised</u>?***

In our view the **central issue** to address is **how to attract and retain investors** for the following targets: innovation, from companies of all sizes[23]; long-term investments[24] (including through equity funding); SMEs as well as mid-sized companies. **As a priority, the following policy measures should be taken in the short-term** to incentivise investments in these areas and ensure their profitability:

- **more favourable tax treatments** (please see our response to question 30)**;**
- **better risk-sharing;**
- **exit opportunities for long-term investments** (please see our response to question 3 as regards ELTIFs)**;**
- **better calibration of Basel III and Solvency II prudential requirements** (please see our responses to questions 6, 10 and 16)**;**
- **improved post-trade market transparency** (please see our response to question 23)**.**

An additional priority is the **recalibration of existing or looming regulations and legislative initiatives** which may penalize investment, liquidity and market making: Financial Transaction Tax (FTT), Banking Structural Reform (BSR), Net Stable Funding Ratio (NSFR)….. This represents a low-hanging fruit for Europe in order to move quickly in creating a more enabling environment for CMU and for accelerating the economic recovery (please see our responses to questions 6, 10 and 16). **Impact assessments should be carried out before any enforcement** (please see our response to question 5)

***2) <u>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</u>?***

No comment.

[23] Not only start-ups.
[24] Not only infrastructure investments, but also support for the economic and industrial structural changes, for example: implementation of new technologies; support of technological and industrial change; support of the energy and ecological transition.

### *3) What support can be given to ELTIFs to encourage their take up?*

The short-term priorities proposed to facilitate access to capital markets and to increase the investor base, especially for SMEs, include supporting the take-up of European Long-Term investment Funds (ELTIFs).

The forthcoming Regulation establishing ELTIFs is a concrete step in the right direction, as such funds have the **potential to channel European savings into the real economy**.

Long-term investment funds (LTIF) offer numerous advantages: they enable investors to diversify their investments, to spread their risks and to access larger scale projects. Thus they may help to better earmark long-term savings for long-term investments, including in equity instruments and corporate bonds.

However, we believe that this instrument **will only** be really useful, and **achieve the goal of increasing long-term investment in productive assets, if it is able to attract a lot of investment from the widest possible range of sources. To that end**:

- the European Investment Bank (EIB) should play a formal role in **guaranteeing the investments**, in order to **facilitate access to such funds for a larger pool of investors**;
- such investments should be afforded the **best tax treatment** of any financial investments (our understanding is that the DG Taxud is currently examining how their tax treatment could be handled);
- **prudential requirements** for insurance companies and pension funds[25] should facilitate such investments. Adjustments to the standard capital requirements of Solvency II and IORPs in view of encouraging concrete investments in ELTIFs will be essential to their success;
- there is a certain category of **investors, belonging to the wealth management**, that, although they fall in the general category of retail investors, possess significantly larger resources as well as enhanced expertise and understanding of the complexity and risks of an investment. We would urge to allow for a more efficient involvement of this particular group of investors in order to fully explore their significant potential to invest in long-term financing projects;
- the ELTIF's manager should have more discretion to create a redemption regime that better fits its investment strategy and underlying assets as long as it is fully disclosed to investors in the ELTIF's rules. The same **flexibility** and discretion should apply to the choice of the lifetime of each ELTIF.

### *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?*

The short-term priorities proposed to facilitate access to capital markets and to increase the investor base, especially for medium to large companies, include supporting the development of the private placement regime and markets.

[25] Pension funds are generally very interested in pooled vehicles which would facilitate access to specific investments, such as infrastructure, project finance or SME funding. Many pension funds have already explored these areas, usually through pooled funds run by specialised asset managers.

It is appropriate to facilitate the use or encourage the development of certain financing instruments or channels suited to long-term investors, such as private placements, which enable to reduce the banks' refinancing constraints and facilitate corporate financing.

In this regard, it is in particular necessary that all companies can domestically use a flexible system, similar to certain existing systems such as **the French Euro PP model, the German model of Schuldscheine or the U.S. model of private placement (USPP – US Private Placement), which may serve as references for defining a suitable European legal framework. This regime should in particular include the following characteristics:**

In France the Euro PP Market in particular has been an initiative of the Paris Chamber of Commerce and Industry, the French Central Bank and the Treasury, with the active support of the industry and its trade associations. It has led to the development of a Euro PP Charter, proposing a code of conduct, best practices, and standard documentation for non-listed bonds and a model agreement for loans. Over the last three years, some €10 bn were issued through Euro PP. However it is important to note that this financing was raised mainly by fairly consequential mid-size firms, some of which could access the capital markets directly. So the issue remains as to how to develop PP markets for smaller SMEs.

In 2014, about 12% of EuroPP issues were by Italian SMEs, following the Italian government's introduction of a decree (now a law) encouraging debt capital markets transactions by expanding favourable tax treatment and allowing institutional and qualified persons to invest directly in SME-issued corporate bonds. Elsewhere, another important development is the Schuldschein Market in Germany which has grown to a volume of about €11bn in 2014. In addition, the US PP market may offer useful lessons for Europe, notably in terms of facilitating the analysis of SME credit risk.

These **experiences should serve as references for defining a suitable European legal framework. This regime should in particular include the following characteristics:**

- be open from a comparable threshold of potential investors across the EU;
- be capable of being put in place rapidly, by foreseeing in particular the possibility that the loan be made by a bank in first place, with the bank looking for participants afterwards;
- be flexible about the duration of the loan;
- provide for the possibility to adjust the terms to the client's needs (repayment…);
- be transferrable to other investors than the initial investor(s);
- require less documentation and disclosure than a bond issue;
- do not qualify as a financial instrument for accounting purposes;
- do not include a rating obligation.

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

**Several measures could help increase access to funding and channeling of funds to those who need them:**

- **address the cumulative impacts of regulatory reforms;**
- **ensure stability of rules and a level playing field;**
- **improve the financing of long-term investment through project and covered bonds.**

Please also refer to our responses to the following questions:

- 6, 10 and 16, regarding prudential requirements;
- 32, regarding information and a resource allocation process.

### 1. Address the cumulative impacts of regulatory reforms

The cumulative impacts of **current and planned** regulatory reforms on non-financial companies and long-term financing should also be assessed before enforcing its rules and addressed, in particular with a view to **facilitating access to financing and hedging transactions**:

In particular, we should highlight the constantly increasing and too often crippling burdens which mean a large number of obligations for companies:

- **obligations relating to financial information, transparency and corporate governance;**
- **reporting obligations relating to the use of derivative contracts by companies, which are liable to complicate hedging transactions and increase the cost of hedging the risks associated with financing instruments**.

Policy-makers should ensure that a proper governance is established around those impact assessments.

### 2. Ensure stability of rules and a level playing field

Finally, regardless of the nature of the obligations (regulatory, fiscal and prudential), it is particularly necessary, on the one hand, to ensure the stability of the relevant rules as far as possible and, on the other hand, to avoid penalising European companies and investors in Europe, by ensuring that the obligations which apply to them are not more restricting than those which apply in third countries.

EU players are handicapped by the non-application, or partial or tardy application of equivalent rules in third countries. Furthermore, the rules applicable within the EU complicate the financing of its economy, particularly by not taking sufficient account of business models.

Thus for example the United States has deferred application of Basel III and has not adopted the IFRS; the requirements of Solvency II only concern European insurance undertakings. In this context, the timetable for implementing Basel III in the EU and the proper calibration of its prudential requirement are essential to consolidate the economic recovery.

### 3. <u>Improve the financing of long-term investment through project and covered bonds</u>

**As regards the instruments offered, measures could be taken to improve the capital market financing of long-term investment, in particular through project bonds and covered bonds.**

**<u>Project bonds</u>**: their use is still limited in volume and in scope, despite their advantages. Not only greater use should be made of project bonds, but also their **scope should be extended** to other key European long-term projects[26]. Easing of rating constraints would be needed to promote their use.

Project bonds have many advantages: these private debt instruments issued by a project company aim to stimulate investment in key strategic European infrastructure projects in the fields of transport, energy, information and communication technology (ITC) and to establish debt capital markets as an additional source of financing.

More specifically:

- they reduce the risks through pooling among private companies and investors.
- they enhance the ability of private investors (in particular institutional investors) to identify long-term projects, to assess the associated opportunities and risks and to match their long-term obligations;
- they benefit from a credit enhancement provided by the European Investment Bank to project companies raising senior debt, which facilitates its placement with institutional investors (while, since the financial crisis, there have been few new issues guaranteed by the monoline insurance companies).

The **development of <u>covered bonds</u> at European level** should, in particular, reduce banks' refinancing constraints and facilitate the financing of capital-intensive industries (e.g. the aircraft, rail or ship industries). An arrangement of this kind could take its inspiration from the characteristics of the German model of Pfandbriefe (medium/long-term maturities; **dynamic cover pools potentially changing over time; investors' preferential claim on the cover assets; choice between private placement and public offering**).

### 6) <u>*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*</u>*?*

The considerable long-term financing needs of non-financial companies in the EU and the constraints on bank financing may encourage companies to have greater recourse to the equity and bond markets, which are called upon to play a more important role than in the past. There can be no doubt that the diversification of funding sources is useful to companies and that it is appropriate to facilitate the use and encourage the development of certain non-bank financing instruments or channels suited to all investors, such as corporate bonds.

It is thus imperative to facilitate the use of corporate bonds and promote greater liquidity in bond markets.

[26] The proposed mechanism of the Project Bond Initiative only targets the European Investment Bank's core business, i.e. infrastructure financing.

**Several avenues – other than standardisation - should be taken** in order to support this trend and further open up the bond markets, by improving how they operate:

**- facilitate access to the bond markets**;

- more generally, **put in place tax regimes that favour investment in companie**s;

- **develop mechanisms for sharing or covering risks** (credit enhancement,…) **and develop or encourage the use of long-term financing vehicles (ELTIFs, etc.)**;

- **maintain a regulatory, fiscal and prudential[27] environment conducive to investment**, particularly in the long term, for European and non-European households, companies and investors;

- **better calibrate the prudential rules** to ensure that they do not affect investors' long-term financing ability and allow them to invest more in shares and private bonds.

**A) facilitate access to the bond markets**:

. encouraging the take up of platforms dedicated to corporate bonds;

. ensuring the transparency of the bond markets and greater visibility concerning issues (please see our response to question 22);

. facilitating the subscription of bonds by retail investors / individuals, particularly through more attractive taxation (direct subscription or in the form of UCITS).

**B)** more generally, **put in place tax regimes that favour investment in companie**s (rather than in real estate assets[28]);

**C) develop mechanisms for sharing or covering risks** (credit enhancement,…) **and develop or encourage the use of long-term financing vehicles (ELTIFs, etc.)**(please see our response to question 3);

**D) maintain a regulatory, fiscal and prudential[29] environment conducive to investment**, particularly in the long term, for European and non-European households, companies and investors:

- **liquidity contracts** should continue to be accepted market practices in the framework of the Market Abuse legislation;

- the application of **legislation on Markets in Financial instruments (MiF)** must enable to ensure that the equity and bond markets function properly (improve the post trade transparency and reduce the number of highly speculative short-term transactions[30]);

-**financial transactions** should **not be subjected to an increase in or a stack of obligations and constraints**, which would result from ongoing legislative proposals: proposal for a Council Directive implementing a European **Financial Transaction Tax (FTT)**, proposal for a European Regulation on structural measures for EU credit institutions ("**Banking Structural Reform"** / BSR)…

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[27] Prudential rules may lead to short-term investments replacing long-term ones; please see in particular E) of our response to question 6.

[28] Except for financing energy savings.

[29] Prudential rules may lead to short-term investments replacing long-term ones; please see in particular E) of our response to question 6.

[30] Automated high frequency trading (HFT) now represents 37% of volumes traded on European equity markets.

In particular, **such obligations would reduce the liquidity of equity and debt instruments - notably corporate bonds - on the secondary markets and therefore, indirectly affect fundraising on the primary markets.** Such obligations would also make utilisation of derivatives more complex and costly, although they are commonly used to offset market volatility and hedge risks, in particular those associated with corporate bonds (foreign exchange and / or interest rate risks).

Special attention should be given to the following:

. the proposed **FTT** would affect non-financial companies in their financing – especially long-term financing – and hedging activities, as transactions on corporate bonds and derivatives would be subject to taxation;

. where applied under the **BSR**, a requirement to separate all market-making activities into a trading entity would result in higher transaction costs and lower liquidity for the long-term securities issued by corporates (bonds and equity instruments), as trading entities would be subject to higher capital and liquidity requirements and thus have a reduced capacity to act as counterparties in the interbank market and vis-à-vis their customers.

. the **NSFR**[31] as currently proposed would be detrimental to the inventory, to repo/reverse repo instruments as well as to derivatives, rendering market making activites less profitable for banks and/or more costly for investors and companies.

**E)** **<u>better calibrate the prudential rules</u>** to ensure that they do not affect investors' long-term financing ability and allow them to invest more in shares and private bonds:

* as regards **insurance undertakings**. It should be noted that the outlook for long-term investments, such as life assurance, is affected by several elements that may threaten their profitability and savings inflows and lead to volatility or to a deterioration in solvency ratios, including uncertainty over taxation and Solvency II prudential rules, threatening significant bond investments;

* prudential requirements may also constitute a barrier to the development of **long-term** investment funds (ELTIF; please see our response to question 3);

* the B III are encouraging **banks** to focus on liquidity and to shift investments from long-term investments to short-term investments and from shares and corporate debt to government bonds; prudential rules do not ensure the neutrality of investment decisions and introduce a bias between sovereign bonds and corporate debt (even though, based on the high levels of public debt, sovereign bonds generally can no longer be regarded as risk-free investments and 100% liquid).

  Concerning the NFSR, the observation period (which is set to last until end 2017) should be fully used to review unintended consequences on corporate financing. In the current set-up, this ratio would have serious implications on banking business models. It would strongly reduce the transformation capacities of banks and limit their credit intermediation role. Indeed, the long term ratio would in particular imply that each euro lent to a company via a one year credit should be covered by a euro of resources over a year. Moreover, this ratio will encourage banks to affect this euro of long-term resource to activities other than credit to the private sector, as this euro of resource would also permit to finance either 20 euro of government bonds, or between 2 and 5 euro of corporate bonds.

[31] As a long-term structural ratio to address liquidity mismatches and provide incentives for banks to use stable sources to fund their activities, the NSFR is due to become a binding minimum standard by 1 January 2018.

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

Apart from limited cases where legislative measures are needed (please see § 2.3 of the summary), it should be **up to the market to provide solutions/guidelines for the development of ESG investment, including in green bonds.**

1. **Green bonds**

Green bonds are increasingly used by companies as well as local and territorial authorities on a voluntary basis. As demand in green bonds is increasing, a consortium of banks has launched in January 2015 the "**Green Bonds Principles**" which are voluntary process guidelines that recommend transparency and disclosure and promote integrity in the development of this fast growing market by clarifying the approach for issuance of a green bond. This example **proves the capacity of the market to respond to the needs for guidance. A regulatory intervention could inhibit the development of such investment and instruments - which we support - and should thus be avoided**.

2. **The approach of the Directive on Non-financial reporting is welcomed by companies**

**As regards the publication of ESG information, companies believe that the Prospectus framework and the recently approved Directive 2014/95/34 of 22 October 2014 on Non-financial reporting** place companies in a longer term perspective – which they support – and **provide an appropriate basis for the information of investors** and other stakeholders**. Indeed, the new Directive will allow easy access to information on the impact of businesses on society by requiring them to give a fair and comprehensive view of their sustainability policies, outcomes and risks.**

3. **Introducing additional requirements, such as a mandatory integrated report, would not be appropriate**

While the approach of the Directive is welcomed by **companies**, they **do not subscribe to the idea of a mandatory or standardized integrated report for the following reasons:**

The idea of publishing in an integrated report complete and principles-based summary financial and non-financial information may appear attractive. However, the concept of **integrated reporting, as understood and applied by companies, should be clearly distinguished from the integrated report model proposed by the IIRC** (International Integrated Reporting Council) in its Integrated Reporting Framework, whose costs would far outweigh its benefits.

It is common for the largest companies to publish summary information gathering or combining financial, environmental and social matters, without however being willing or able to use the IIRC Framework or other frameworks.

While appreciating that the **IIRC** Framework is voluntary only, companies emphasize that applying or referring to this Framework on a voluntary basis nevertheless translates into **requirements from the IIRC**, **some** of which are clearly **excessive**. Indeed, the application of certain key elements of this

Framework – measure of capitals and value creation, connectivity of information, reporting boundary... – faces **major conceptual difficulties** and would result for companies in **disproportionate burdens and costs, without** ensuring the **relevance and** the **reliability** of the information published. Therefore the **publication** by companies **of a report such** as that currently being **promoted by the IIRC**, or a reference to the IIRC Framework, is **inapplicable or problematic.**

**Only some of its elements could be used as an internal reference** by companies which so wish in order **to improve the presentation – not the content - of the information they are required to publish under European legislation**.

Looking for an overview of the long-term performance by increased integration of financial and non-financial information would assume that the following conditions are met:

A. Financial information cannot be sufficient to reflect the long-term performance;

B. The principles applicable to non-financial information are consistent and have reached the same level of maturity than those applicable to financial information;

C. The principles applicable to non-financial information enable to reflect a long-term performance.

On the contrary, the following should be underlined:

**A. Financial information may be sufficient to reflect the long-term performance:**

- **The adaptation of certain accounting rules, in particular of IFRS, should be the preferred route**; when measuring performance and designing valuation methods, it is particularly important **to better reflect** the **business models**, management time-horizons and approaches, as well as the possible interaction between assets and liabilities;
- **Beyond accounts, the items that are likely to have a significant impact on investment decisions, in particular the most relevant non-financial elements** (environmental, social...) **are already embedded in the financial information –** in particular in the management reports, the prospectuses and the press releases responding to the ongoing information requirement -;
- **As mentioned above it would not be possible to foresee a systematic integration of non-financial information**. E**nvironmental and social information**, be it is published either voluntarily or under a legal obligation, is often qualitative; it **can enrich the analysis by investors, but in no case may represent a non-financial performance that could be integrated with financial performance into a single report**.

B. **The principles applicable to non-financial information are closely linked to industries, are not readily comparable, cannot be consolidated, and are still insufficiently implemented.**

- There are currently **no generally accepted "non-financial information standards", but several sets of principles, which differ widely from financial reporting frameworks**; in particular, these sets of principles:
  - are often qualitative in nature and can focus more on approaches or processes;
  - request only rarely specific quantitative data or indicators, even more exceptionally monetized indicators;
  - unlike financial reporting standards, generally do not include recognition, measurement and presentation principles in relation to these data or indicators. This is in particular because the indicators (social, environmental,...) often are not consistent and comparable (eg they can vary from one country to another);

. thus generally cannot be consolidated at group level.

- **the relevance of non-financial information is assessed primarily from the nature of the business activities. Therefore it is up to each business sector to define or develop, where possible, appropriate information;**
- **the level of reliability of non-financial information is still much lower than that of financial information. Integrating financial and non-financial information further would be a source of confusion for investors.**

C. **The principles applicable to non-financial information do not enable to better reflect long-term performance**.

- **The public disclosure of a long-term performance based on non-financial information would require a greater use of estimates and the disclosure of assumptions.** Given the many uncertainties and the limitations mentioned above, **this would** be particularly difficult, give rise to significant liability issues and **involve frequent publication of profit warnings. While the objective of reflecting a long-term performance looks legitimate at first sight, the publication of prospective non-financial information to that end could eventually lead to increase short-termism**;
- **The principles applicable to non-financial information would not enable to reliably solve major problems that have not been settled for financial information**: difficulties linked to the forecasting exercise; extreme complexity, or even impossibility, to reliably measure other than financial capitals (intangible, human, natural...), of which the company is not necessarily the sole owner, and, therefore, to measure the value creation; disclosure of commercially sensitive information (strategies, opportunities, resource allocation, intentions, data relating to research and development...)...

***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 comment.

***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 comment.

***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?***

**Three types of policy measures could incentivise institutional investors to raise and invest larger amounts in a broader range of assets:**

**1) the facilitation of funding through certain instruments and channels;**

**2) the development of high quality securitisation;**

**3) a better calibration of prudential requirements and a stability of the rules applying to occupational pension funds.**

### 1. Facilitate the investment in instruments and channels that complement bank direct lending

It is useful to **develop** the following channels and instruments that can be used by institutional investors:

- **ELTIFs** (please see our response to question 3);
- **private placements** (please see our response to question 4);
- **covered bonds and project bonds** (please see our response to question 5).

### 2. Develop high quality securitisation

**Corporate loan securitization, concerning in particular loans to SMEs and mid-sized companies, should be developed, while seeking the right balance between financial stability and the need to improve maturity transformation**.

Securitisation enables banks, on the one hand, to reduce their exposure to transformation/liquidity risks, at the same time as being involved in analysing and managing the credit risk, and, on the other hand, to free capital, which can then be mobilised for additional lending.

It leads to a more direct relationship between companies and investors, but makes them bear the risks linked to holding assets (credit and liquidity risks), by nevertheless pooling these risks. The sub-prime crisis demonstrated, moreover, that not completely knowing the content of special purpose vehicles could entail systemic risks, particularly in the case of resecuritisation (which the CRD IV prevents now).

Against this background**, different issues need to be addressed**:

- given the wide diversity of companies, in particular SMEs and mid-sized companies, there is a challenge for **identifying homogeneous classes of related assets** for the purpose of securitisation, if it is to substantially contribute to the financing of businesses;
- when defining simple, transparent and high quality securitisation:

  . the **traceability** of securitised assets and issued securities should be ensured, to maintain financial stability and avoid exposing investments (from corporates and others) to excessive risks;

  . a key question to consider is the **extent to, and the conditions under, which security holders may benefit from a guarantee** (this feature is a key driver of the US securitisation market) **or from refinancing operations with the European Central Bank (ECB)**;

  . the take up of securitisation will take time and the effects on the financing of companies are uncertain. It is thus essential to **recognise the central role of banks in** CMU and **direct lending**.

## 2. Better calibrate prudential requirements

Below we set out the significant cumulative impacts of current and planned prudential reforms on the level and cyclicality of aggregate long-term investment and how such impacts could be best addressed.

### 2.1. The cumulative impacts of prudential reforms

While fully appreciating that the prudential reforms are aimed at achieving financial stability, we must also take account of their contrasting effects on the long-term financing system as a whole, and therefore on the economy in general.

The prudential environment of institutional investors in Europe has changed profoundly and quickly, and there are clearly cumulative negative impacts on the availability of long-term financing. In brief, current prudential reforms are all based on the following two principles: market-based valuation of all assets and liabilities; risk-based models to compute capital requirements (like Value-at-Risk).

These prudential frameworks have the following consequences on institutional investors:

- undue volatility of their balance sheet and far higher capital requirements;
- strong incentive to focus on liquidity and to shift investments from shares and corporate debt to government bonds (regarded as “risk-free” investments) and from long-term investments to short-term investments:

  . although, based on the levels of public debt, sovereign bonds generally can no longer be regarded as risk-free investments, prudential rules do not ensure the neutrality of investment decisions and introduce a bias with corporate debt;

  . the current prudential reforms have already led insurance undertakings and banks to reduce their investments in shares - for billions of euros -.

The prudential rules for insurance undertakings and banks significantly increase the impact of other factors threatening investment in the shares and debts of European companies:

- macroeconomic factors: unfavourable outlook compared with other parts of the world; in a tough economic environment, increase in short-term saving by households (particularly precautionary saving); competition from sovereign bonds;
- in some cases:

  . a fall in the results or credit notes of companies;

  . factors detrimental to long-term investment: unattractive or dissuasive taxation, lack of appropriate vehicles such as pension funds, short-termism trend on the markets.

Eventually, institutional investors are being forced altogether into a vicious circle. Much has been said already about the negative side-effects of such “pro-cyclical” regulation, especially by the OECD. As they have to raise large amounts of equity to meet their new prudential obligations, to sell risky assets in a bottom-of-cycle market, to reduce their business exposure, institutional investors are less able to finance the real economy over the long-term.

### 2.2. How to address the cumulative impacts of prudential reforms

To address the issues mentioned, prudential reforms concerning insurance undertakings and banks should be calibrated at best to minimize their macro-economic consequences. Their impacts should be reassessed and addressed, in respect of bank financing, equity and corporate debt financing. In particular, it is necessary to avoid prudential rules leading to some long-term investments being moved to short-term investments.

#### 2.2.1. Better calibrate the prudential rules which apply to insurance companies

The impact of a crisis of confidence would be considerably greater in an economy where financial institutions would be encouraged to favour short-term financing. In this respect, it is necessary to avoid significant outflows from life assurance which, if this were anticipated or were to occur, would probably lead insurers to reduce the duration of their assets and increase their liquidity in order to cover redemptions.

The outlook for long-term investments, such as life assurance, is affected by several elements which may threaten their profitability and savings inflows and lead to volatility or to a deterioration in solvency ratios, namely volatile and uncertain equity markets, low interest rates, uncertainty over taxation, prudential rules and uncertainty over sovereign debt, threatening significant long-term investments. In particular the role of insurers in the long-term financing of companies could be altered by the Solvency II (S II) reform, which is disadvantageous for long-maturity assets.

Therefore it is essential to **review the prudential rules for insurance undertakings to ensure that they do not affect the long-term financing ability of insurance companies and allow them to invest more in shares and corporate bonds.**

**Adjustments should be performed in such a way that regulatory asset risk capital charges do not weigh on long-term investments, such as infrastructure investments – and on the holding of long-term assets.**

Furthermore, it is desirable for the prudential model to recognise the positive effect of long-term liabilities for long-term investment, at the same time as including statistically stable liabilities in the definition of these liabilities.

#### 2.2.2. Avoid the adverse effects of the rules which apply to pension funds and banks

**It is also important:**

- **to ensure that the liquidity rules of Basel III do not encourage banks, which are traditionally major distributors of life assurance policies, to first steer their clients in the direction of banking products deemed equivalent to deposits** (for more details, please see our response to question 16)**;**
- **not to affect the role that occupational pension funds (IORPs) play in the long-term financing of the economy.**

  The ongoing review of the IORP Directive (IORP II) should be designed so as to avoid negative effects on long-term financing of the real economy in Europe. The Quantitative Impact Study (QIS) preliminary results released on 9 April 2013 clearly showed that pension funds are huge and steady holders of long-term investments. In the United Kingdom and the Netherlands, which are by far the two largest countries for IORPs with over € 2,000 bl. of assets, equity and property holdings weigh a half of total investments.

***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?***

No comment.

***12) Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets? If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?***

Growth will return to Europe and be sustainable only if its infrastructure financing needs are covered, in particular those that facilitate and secure free flow of goods, energy and services through appropriate transport, energy[32] and communication infrastructures / networks, and that ensure the protection of these infrastructures.

**Prudential requirements must be such that they are not unfavourable to infrastructure investments** from financial institutions -, in particular institutional investors, such as insurance companies and pension funds – that pursue a long-term investment strategy. These **investors should be encouraged to invest long-term capital**.

**Preferential treatment** should not only benefit a broad range of infrastructure investments, but should **also** be used to **support the economic and industrial structural changes**, for example: implementation of new technologies; support of technological and industrial change; support of the energy and ecological transition.

***13) Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?***

One of the obstacles to boosting long-term financial resources and to the development of EU capital markets – in particular by contrast to the US – results from the characteristics of pension provision. , **Pension schemes and products, as well as long-term savings products – such as insurance life contracts** - **should be encouraged**: they constitute responses to the European **demographic challenge** and long-duration liabilities - such **as pensions, insurances and, increasingly, of long-term care / dependency** - and a natural source of increased long-term liabilities to financial institutions. Also social transfers will be limited by the scarcity of Member States' resources. Furthermore long-term savings products could overcome the structural lack of long-term resources in Europe. It should be noted that their development in the US was parallel to the increase of the disintermediation ratio.

Therefore appropriate **investment instruments - including, but not limited to, pension funds and personal pension products - must be available to long-term investors / households on a voluntary basis**. Pension and other long-term savings products, which can contribute to the sustainability and adequacy of pension systems, are likely to form a growing part of European pension systems.

[32] 1 600 Md€ by 2020 according to the assessment referred to by the European Commission in 2013.

It is appropriate to **promote the introduction or development** of such long-term investment vehicles, in particular **by introducing standardised products** - for example through a pan-European or "29th regime" - **and by defining attractive taxation regimes for investors**.

***14) Would changes to the EuVECA and EuSEF Regulations make it easier for larger EU fund managers to run these types of funds? What other changes if any should be made to increase the number of these types of fund?***

No comment.

***15) How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?***

No comment.

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

The financing of the European economy is crippled by a structural lack of long-term resources. Indeed, in all developed economies, the market of savings faces an **imbalance** between:

- on the demand side: companies and general government needs, which request **long and risky financing**;
- on the supply side: **households**, which are net providers of savings (at high levels in the EU), with a **preference for safety and liquidity**.

**It is essential:**

- **to facilitate the diversification of financial instruments used by companies, in addition to bank financing;**
- **to preserve the key role of the banking maturity transformation and to minimise the impacts of the Basel III agreements (B III) and sovereign debt tensions on the financing of companies;**
- **to ensure favourable conditions for companies regarding the use of alternative long-term financing channels.**

**1. Facilitate the investment in instruments that complement bank direct lending**

In addition to securitization (please see our response to question 10), it is useful to develop the following channels and instruments that can be used companies that need finance:

- bond markets (please see our response to question 6);

- ELTIFs (please see our response to question 3);
- private placements (please see our response to question 4);
- covered bonds and project bonds (please see our response to question 5).

## 2. Preserve the key role of the banking maturity transformation and minimise the impacts of the Basel III rules on the financing of companies

### Preserve the banking maturity transformation

It is relevant to assess whether the prudential rules for banks effectively improve the resilience of the financial system as a whole, to ensure that these rules may not have unintended consequences and to consider the impact of prudential rules for banks on the long-term financing for the real economy.

Given the scale of long-term financing requirements, the difficulty of funding them adequately with long-term resources and the time needed to develop securitisation, the transformation function is indispensable, in particular for SMEs and mid-sized companies. Banks, beyond their role as financial intermediaries, play a **fundamental role in correcting the imbalance between the supply and the demand of financial resources**, through their credit distribution and transformation activities (by transforming short and liquid deposits into funding that is generally less liquid and of a longer horizon). Looking at asset-liability positions in detail on a sector by sector basis shows that, in fact, **banks are the only institutions to operate maturity transformation in Europe**. This fact is widely recognized and is clearly demonstrated by the results of the various Quantitative Impact Studies conducted by the Basel Committee as well as the European Banking Authority.

The **impact** will be particularly severe **in most European economies**, as the non-financial private sector relies very heavily on bank credit. Indeed, banking intermediation for non-financial private sector (corporates and households) represents roughly 80% of debt financing. It even represents above 95% for SMEs in some Member States.

**European banks are in the process of scaling down and/or reorienting their activities**. In particular, medium and long term financing activities with long maturity or low profitability are reduced, as these are very costly in terms of liquidity and funding under the new prudential requirements. This includes activities **such as infrastructure investments (project and export finance), lending to SMEs, mid-sized companies and to public entities** such as municipalities and mortgage lending. For example, it will be less economically viable for banks to finance large scale infrastructure projects.

The situation is characterised by credit tensions (financing of long-term projects or occasionally, exports) and an increase in the cost of credit, and is encouraging industrial and commercial companies to seek out alternative sources of financing, not without difficulty. This situation is at odds with the Europe 2020 strategy to achieve a smart, sustainable and inclusive European economy and is at odds with efforts to promote long-term investment.

In this context, restricting bank credit for companies and/or increasing its cost are liable to discourage investment and be detrimental to growth and employment, with negative consequences in terms of the competitiveness of companies and reducing public deficits.

**Minimise the impacts of the Basel III solvency and liquidity rules on the financing of companies**

- The measures aiming to raise the capital levels of banks are needed in order to improve the security of the global financial system, offset the effects of impairments in the securities held, restore confidence in the banking system (confidence of banks and markets) and enable the financing of the economy. However, **the objective of the stable financing of the economy cannot be achieved without resolving the issue of the value of European sovereign debts and, upstream, the issue of reducing public spending and debt**.

Everybody is in agreement that sovereign debt tensions upset previously existing balances. These tensions, which are the result of high levels of government debt and the sub-prime crisis, may produce the same effects as it did, namely reduced confidence in the banking system and indeed between banks, reduced transactions on the interbank market, sometimes constrained access to liquidity, tighter credit conditions, impairment of banks' securities, and slump or weakness in the equity markets.

- **The calibration of European bank recapitalisation objectives and the schedule for implementing B III are essential to avoid a recessionary spiral**. In particular, these should take into account:

  . the capacities of banks, weakened by a possible fall in profitability and problems with recourse to markets;

  . the value of sovereign debts and government constraints related to a range of factors, namely growth forecasts; scale and rating of their debt; need to secure the banking system and the financing of the economy.

- **The B III measures relating to liquidity should preserve the transformative role of banks and achieve a balance between holding government securities and other assets:**

**The two standards[33] developed by the Basel committee for funding liquidity will mechanically limit banks in their transformation capacities**. Altogether, holding long term assets will be penalized by the necessity to hold so called liquid assets (mostly sovereign debt and deposits to central banks).

While B III may encourage companies to have greater recourse to the markets, particularly through bond issues, we may **question the appropriateness**, in a context of sovereign debt tensions, **of liquidity rules encouraging banks to hold government bonds**, which are considered to be 100 % liquid, even though government financing needs remain at a particularly high level.

. **Concerning the LCR, high quality assets that are eligible to central banks** (corporate loans, consumer credits, residential loans) **should have been recognized as liquid assets** to cope with the predominant financing of the European economy by banks:

- firstly it would be more in line with the situation in the US where around 50% of outstanding mortgages are refinanced thanks to US government-sponsored enterprises (Fannie Mae, Freddy…);

[33] The Liquidity Coverage Ratio (LCR) is set to regulate banks on their short run liquidity management. In parallel, the Net Stable Funding Ratio (NFSR) is set so that banks will better match the maturity of their resources according to the one of their uses.

- secondly it would put an end to the current absurd situation where the monetary policy of the European Central Bank (ECB) is partially inefficient (since huge amounts of money are deposited in Central banks to build up liquidity buffers instead of financing the economy). This incoherence of the monetary policy is best illustrated by the Long-term Refinancing Obligations (LTRO) that the ECB set up to inject long term liquidity in banks… an abundance of liquidity that came immediately back to the ECB in the form of deposits. Due to these excess liquidities, the monetary policy has reached its limits, as the ECB is left with hardly any leeway apart from deciding to sterilize a more or less large quantity of these liquidities.

. Like the LCR, **the net stable funding ratio (NSFR) must be relaxed before its scheduled entry into force in 2019**.

Concerning the NFSR, the observation period (which is set to last until end 2017) should be fully used to review unintended consequences on corporate financing. In the current set-up, this ratio will have serious implications on banking business models. It will **strongly reduce the transformation capacities** of banks and limit their credit intermediation role. Indeed, the long term ratio would in particular **imply that each euro lent to a company via a more than one year credit should be covered by a euro of resources over a year**. Moreover, this ratio will **encourage banks to affect** this euro of long-term **resource to activities other than credit to the private sector**, as this euro of resource would also permit to finance either 20 euro of government bonds, or between 2 and 5 euro of corporate bonds.

Furthermore most capital market activities would be subjected to a quite **adverse treatment** by the NSFR, in particular:

- **market making activities**, through the penalizing treatment of:
  - security inventories (essential to perform market making);
  - matched book (key driver of liquidity);
  - repos (to refinance the inventory).

  As a consequence providing market making services would become very expensive and the NSFR compliance cost would be well above the profitability of these activities. The NSFR would require the highest quality sovereign debt to be long term funded for a portion between 5% and 10% of the held amount versus a haircut of 0% allocated to LCR for these securities.

  Liquid shares would require 50 % stable funding, whereas their actual liquidity at more than 1 year horizon should require a much lower percentage.

  The suggested asymmetrical treatment for repos and reverse repos with non-financial counterparties would have a direct detrimental impact on market making activities. Indeed, the NSFR would act as a disincentive to enter into reverse repos with non-banks (i.e.: insurers and asset managers), which would limit their responsiveness to meet buy orders.

- **Derivatives activities,** which are essential to allow market makers to hedge their inventories, through:
  - the penalizing treatement of initial margin ( 85% will require one year funding);
  - the obligation to receive cash collateral to benefit from the netting;

. the fact that total liabilities after netting with derivatives assets would require 20% stable funding at one year;
. the fact that hedging relationship between short term derivatives and security inventory which hedge derivatives would be completely disregarded.

As a consequence, hedging of corporate and institutional clients, investments of institutional and individual clients as well as financing of institutional and corporate clients would be affected and become either too expansive or will be winded down.

**3. <u>Ensure favourable conditions for companies regarding the use of alternative long-term financing channels</u>**

The European prudential rules for banks aim to address the risks associated with making excessive use of leverage and maturity transformation. Along with interconnections between banks and sovereigns, this has led by deleveraging by many banks, contributing in particular to the current scarcity of long-term financing.

The increase in prudential rules for banks leads them to increase their medium- and long-term resources, but also lead to other long-term financing channels being contemplated, involving:

- financial markets;
- institutional investors;
- through other intermediaries that are not subject to the prudential rules for banks and to the restrictions on maturity transformation (investors acting alone / directly or complementing the role of banks in an « originate-to-distribute » model);

Consequently, **favourable conditions should be ensured for the use of** these **alternative channels by companies. Banks have an important role to play here**:

- in an **"originate-to-distribute" model**, banks no longer carry loans and resources, but have to match up the interests of investors and financing needs, by lending their expertise in the assessment and selection of projects to be financed. This role is **particularly important due to the fact that the risk is borne by the final investors, be they households or institutions (particularly insurers);**
- when markets are used, banks play an important **market-making** role for securities issued by companies, which are a key vehicle for their long-term financing.

***17) <u>How can cross border retail participation in UCITS be increased</u>?***

No comment.

***18) <u>How can the ESAs further contribute to ensuring consumer and investor protection</u>?***

The European Supervisory Authorities (ESAs), as technical advisors to the EC, are currently preparing many draft delegated acts and regulatory and implementing technical standards for adoption by the EC, which correspond to the numerous level 1 texts adopted in the previous legislature[34]. The powers of ESAs are sufficient to play an important role in that capacity and in ensuring consistent

[34] In total, around 400 delegated acts are expected.

implementation and application of EU law across the EU. Their action should **now focus on organising and monitoring control methods and programs at EU level to ensure a level playing field between the undertakings concerned**, with the **implementation** of controls remaining within the **remit of national supervisory authorities**[35]**.**

***19) What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?***

The financing of the economy is crippled by a structural lack of long-term resources. Indeed, in all developed economies, the market of savings faces an **imbalance** between:

- on the demand side: companies and general government needs, which request **long and risky financing**;
- on the supply side: **households**, which are net providers of savings (at high levels in the EU), with a **preference for safety and liquidity**.

Therefore **long-term retail savings should be encouraged**: they constitute responses to the European demographic challenge and long-duration liabilities - such as pensions, insurances and, increasingly, of long-term care / dependency - and a natural source of increased long-term resources to meet the needs of the real economy. In channelling these savings, priority must be given to productive investment, including long-term investment.

This involves **three types of policy measures**:

- putting in place **tax regimes** that channel savings as a matter of priority into productive investments - in particular long-term investments - and that take account of the need to reward risk-taking: tax regimes should favour investment in companies rather than in real estate assets[36]. It would seem particularly advisable to coordinate tax policies, to avoid intra-European distortions and to take account of best practices, in order to achieve this objective at EU level (please see our response to question 30);
- facilitating the **subscription of shares and corporate bonds** by individuals, particularly through more attractive taxation (direct subscription or in the form of UCITS) and **access to the bond markets** (please see our response to question 6);
- developing **other long-term financing vehicles** (LTIFs, other retail investment instruments - including, but not limited to, access to pension funds and personal pension products -, etc.) and **mechanisms for sharing or covering risks** (credit enhancement, etc.; please see our responses to questions 3 and 13).

[35] With the exception of banks that are supervised directly by the ECB.
[36] Except for financing savings energy and energy efficiency.

***20) <u>Are there national best practices in the development of simple and transparent investment products for consumers which can be shared</u>?***

No comment.

***21) <u>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</u>?***

The main stake for the EU and the Member States is to remain attractive as an investment destination for **all investors, from third countries and the EU as well**. In that respect, the long-term growth prospects of the European economy depend above all on the ability of public policy-makers to create **<u>economic conditions</u>** that boost growth and generate savings **and a <u>fiscal and regulatory environment</u>** that is **<u>conducive to investment</u>**, in particular long-term investment.

The Green Paper mainly focuses on **lending vehicles and capital markets**. Lending vehicles and effective capital markets, as well as the financial sector's ability to channel savings into productive investment are **essential, but** alone are **insufficient**.

The challenges for the EU and the Member States are as follows:

- in a context of weak growth, to present **<u>clear policy guidelines</u> and more favourable prospects to:**
  - . **restore economic fundamentals in order to attract liquidity from** zones and countries **outside the EU, while ensuring that the considerable savings which the EU still has available are invested in the EU** as a matter of priority.
  - . **restore EU companies' competitiveness and self-financing capacities;**
  - . **encourage or prompt companies and households to invest over the long term.**
- to generate long-term savings in the European Union, based on the long-term requirements of savers (please see our response to question 13) and investors.

In this context, the **role of financial regulation** is to address the structural gap between supply and demand for long-term financing, by performing **three key functions**:

- . **<u>enable financing to be allocated to the most relevant productive investments</u>** for competitiveness and growth, particularly in the long term, thereby providing a **tool of economic and industrial policy** (please see our response to question 32 regarding the resource allocation process);
- . **<u>adapt and then stabilise the legislative and regulatory framework</u>**;
- . define and implement **<u>fiscal policies</u>** and calibrate **<u>prudential measures</u>** in order to steer savings in the direction of long-term investments in the real economy and to take into account the need to remunerate risk-taking (please see our responses to questions 30, 6 and 16).

***22) What measures can be taken to facilitate the access of EU firms to investors and capital markets in third countries?***

No comment.

***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?***

Shares and corporate bonds are set to play a growing role in the long-term financing of companies, taking into account the constraints on bank financing and the weakness of investments. Several avenues should be taken in order to support this trend and further open up the equity and bond markets, by improving how they operate. From the perspective of issuers, well-functioning capital markets constitute a prerequisite.

Since 2007, the implementation of the legislation on Markets in Financial instruments (MiF) and the technological developments have led to an increased number of trading venues, to fragmentation in both markets and liquidity, as well as to the rise of high frequency transactions (HFT), which now represent 37% of the trading volumes (in the United States 50% on the sovereign bond spot market and 60 to 70% on the sovereign bond future market).

These developments and the insufficient transparency of transactions and orders seem rather often to undermine essential objectives:

- facilitate the financing of the economy, in particular over the long term – the central role of capital markets -;
- encourage issuers and investors, especially long-term investors, from using capital markets. Moreover high frequency trading adversely affects the equal treatment of investors and may destabilize markets and prices;
- reduce financing costs.

We support the objectives of the MiF legislation and of the European Commission to enhance transparency and market information efficiency and provide a better framework for high frequency trading activities. However further efforts are needed to implement certain provisions of this legislation.

The fragmentation of markets and liquidity should be compensated for by greater post-trade transparency and better regulation of all order execution venues, thereby contributing to meet several key objectives for companies: preserving the price formation process - the basis for assessments and decision taking -; verifying the best execution of orders; ensuring financial stability and market integrity.

The following measures seem to be capable of better regulating high frequency trading:

- application of the same proposed organisational and supervisory regimes to all organised trading venues;
- minimum period of time before an order can be cancelled;

- higher fees for orders that are subsequently cancelled, on participants placing a high ratio of cancelled orders to executed orders and on those operating a HFT strategy (with possible adjustments of fees for cancelled orders according to the length of time for which the order was maintained). Delegated acts should set the maximum ratio of unexecuted orders that can be adopted and would ensure that tariffs are not likely to disrupt the proper functioning of the market.

**It is essential:**

- **to establish a European database of consolidated post-trade data. If market forces do not enable to deliver comprehensive, consistent and affordable post-trade data, recourse to alternative options, including a mandatory tape, should be contemplated;**
- **to strictly control High frequency transactions (HFT), whose business model is based on an order cancellation rate of 95% that is likely to drive the market in favour of their initiators.**

*24) In your view, are there areas where the single rulebook remains insufficiently developed?*

While fully appreciating that the recent reforms are aimed at achieving financial stability, we must also take account of their contrasting effects on the financing system as a whole, and therefore on the real economy. **We do not support the development of new legislative measures, apart from the following limited exceptions**, which aim **to incentivise investments and ease corporates'reporting requirements**:

- **correction of inconsistencies in level 1 measures**, essentially as regards prudential requirements and ELTIFs, to give them more flexibility (please see our responses to questions 3, 6, 10 and 16);
- **development of level 2 measures provided for by adopted level 1 legislation, ensuring proper calibration of Basel III and Solvency II prudential requirements** (idem)**;**
- **easing the reporting burden on businesses, through the review of the Prospectus Directive**[37]**, a review of the European Market Infrastructure Regulation/EMIR or other measures.**

*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?*

The European Supervisory Authorities (ESAs), as technical advisors to the EC, are currently preparing many draft delegated acts and regulatory and implementing technical standards for adoption by the EC, which correspond to the numerous level 1 texts adopted in the previous legislature[38]. **The powers of ESAs are sufficient** to play an important role in that capacity and in ensuring consistent implementation and application of EU law across the EU. Their action should **now focus on organising and monitoring control methods and programs at EU level to ensure a level playing field**

[37] In particular, the content and status of the summary of the prospectus should remain unchanged.
[38] In total, around 400 delegated acts are expected.

**between the undertakings concerned**, with the **implementation** of controls remaining within the **remit of national supervisory authorities**[39]**.**

***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 comment.

***27) What measures could be taken to improve the cross-border flow of collateral? Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?***

No comment.

***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?***

One of the main obstacles derives from the instability and the complexification of the rules. Therefore, new policy initiatives should be subject to a solid impact assessment and simplification of key existing legislation should be pursued.

In the field of **corporate governance**, the European Commission (EC) should leave sufficient room for **self-regulation by companies**, enabling them inter alia to make quick decisions for business reasons[40]. The principles of corporate governance should not remain fixed in Community texts; rather, they need to be able to evolve and adapt rapidly at the request of investors and with market needs.

Rather than moving in the direction of detailed rules that may not apply to a particular company or its environment, the EC ought **to privilege as far as possible the rules aimed at reinforcing the obligations of transparency based on the principle of "comply or explain"**. This principle has proved to be effective. With regard to France, studies carried out each year, on the application by the SBF 120 companies of the principles of corporate governance, make it possible to measure the progress achieved from year to year. **Further legislation** is therefore **not necessary**.

[39] With the exception of banks that are supervised directly by the ECB.

[40] European legislation should not have anti-competitive effects. For instance, it would appear that, at the European level, there is a tendency to foresee more and more shareholders votes on decisions that are, under national law, under the management's competence. This is an issue for companies, which need to make quick decisions, like their competitors. The respective roles and missions of the general meeting, the board of directors and the senior management should continue to be defined in national legislation.

In the field of **company law**, after several years of intense legislative activity (Revision of the Shareholders Rights Directive, etc.), it is **necessary to pause and allow for the transpositions to be completed and the acquis to be assimilated**. In light of the current legislative instability, company legal departments note that they are spending more and more time overseeing legislation and regulations and verifying that the company is correctly complying with one or other regulation, which detracts from the time available to the company's core activities.

Therefore, the Commission should **legislate only in those domains in which a European action would prove to be strictly necessary**.

**Targeted measures could be useful in the following three areas**:

- It would be advisable to take measures aimed at eliminating obstacles to the **development of the financial participation of employees** in the European Union. We deplore the fact that since 2003, there has been no progress in this matter on the European level;
- The Directive on cross-border mergers of corporations might usefully be supplemented by measures regarding the **partial transfer of assets**, that is, the transaction whereby a company contributes to another (whether new or already existing) a portion of its assets, and receives in return shares issued by the company that is the beneficiary of these contributions;
- Two obstacles to companies' **cross-border mobility and restructurings** should be removed:

  . To facilitate the **cross-border movements** of companies within the EU, the process of creation of a European company and the transfer of its place of incorporation from one Member State to another should be simplified. The European Company does not fulfill its role efficiently, as a transfer of the registered office within the EU requires the drawing up of a transfer proposal, a report justifying the legal and economic aspects of the transfer and the issuing, by the competent authority in the Member State of registration, of a certificate attesting the completion of the required acts and formalities;

  . In a **cross-border restructuring** within the Union, there should be an exception to the set-up of the Special Negotiation Body (SNB), when the merged company does not have any employee between the publication of the merger documents and the effective date of merger (the process includes the formation of the SNB with the employees' representatives through a complex set-up procedure and a negotiation process around employees' participations, even when the company to be merged does not have employees, which has no relevance).

***29) <u>What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market</u>?***

No comment.

***30) <u>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</u>?***

One may regret the absence of a common political vision at European level in the field of taxation. Therefore it is essential to support and implement the initiatives aimed at providing as many Member States as possible with a common economic governance and a common economic direction, aiming in particular to **deepen coordination of policies at EU level, including tax and social policies**.

Better coordination between States would prevent the implementation in isolation of fiscally attractive practices that could be harmful to other States. In this respect it is unfortunate that this lack of coordination between States ultimately results in companies being held responsible for tax optimization practices, while tax benefits derive from differences in legislation in States where these companies conduct their business.

Companies consider that **Common Consolidated Corporate Tax Base (CCCTB) would be the best way to deal with these difficulties**.

More specifically, **the financing of the economy**, in particular the financing of long-term investment, **would benefit from a set of EU recommendations rules concerning the tax treatment of savings and corporate income tax**, as it relates to investments and the financing of businesses.

The need to make progress is **more pressing than ever**. The tax treatments associated to financing and savings/investment should foster longer duration, more risky and/or less liquid investment into corporate shares and bonds, as well as related funds (including ELTIFs). It seems particularly advisable to set or adapt the right tax incentives, taking account of best practices, to avoid intra-European distortions and to ensure the **stability** of the relevant rules, which is essential for companies and investors alike.

Finally some provisions should be reconsidered to **facilitate cross-borders flows**.

## 1. Considering corporate income tax

Taxation is not the only criterion determining companies' investment decisions and funding choices. However taxation may have an impact on the profitability and financing cost of investments and thus interfere with these decisions and choices.

### Corporate income tax relating to financing conditions

Most countries tax debt and equity differently for the purposes of their domestic law. Interest on debt is generally a deductible expense of the payer and taxed at ordinary rates in the hands of the payee. Dividends, or other equity returns, on the other hand, are generally not deductible and are typically subject to some form of tax relief (an exemption, exclusion, credit, etc.) in the hands of the payee.

Some consider that this difference of tax treatment encourages companies to favor financing of investment through debt although using equity: way of financing business would only be considered as regards tax aspects

This is based on a wrong analysis according to which financing by debt or equity is the same, although equity financing implies an increase in the share-capital and then the entering of new shareholders, which may be an issue in particular for mid-sized companies. Then, introducing a provision aimed at limiting the tax deduction of interest would not favor equity funding, but would only increase the cost of debt financing, and more broadly the cost of financing.

**The deductibility of interest on debt**, which is a **real burden** on companies, **should not be challenged t**. Rather it would be desirable to eliminate the tax distortion affecting equity financing. **Allowing the deduction of a notional interest attributable to the company's equity should be considered**, like under schemes existing in several European countries (Belgium, Italy NID regime).

**Corporate income tax relating to investment conditions**

Incentives to invest also involve fiscal measures to support companies that develop or acquire assets or other businesses. These measures improve the return on investment and thus are likely to trigger investment decisions.

Tax measures for tangible assets generally appear to be addressed appropriately at national level (nature, conditions and duration of the measures).

However there are disparities between Member States as regards the treatment of intangible assets (trademarks, goodwill...), as Member States do not provide the opportunity for companies to systematically depreciate intangible assets and/or to deduct depreciation expenses or impairment losses for such assets.

Therefore it would be **necessary that all companies within the European Union can benefit from a fiscal regime that encourages the acquisition or development of intangible assets.**

This would offer **significant benefits for the EU**:

- accelerate the transition of the economy towards immaterial and service activities, which are key for the future;
- contribute to maintain in the EU intangible assets and the related revenues (fees, in particular);
- ensure a level playing field for all European companies, in particular vis-à-vis third-country companies.

## 2. Reviewing the tax treatment of savings

Taxation is an essential tool for guiding household savings into long-term financial instruments and for rewarding risk-taking. The tax treatment of savings must allow these savings to be channelled as a matter of priority into productive investments.

Public authorities must set or adapt tax incentives to mobilize savings for long-term investment in companies' equity and corporate bonds. Attractive taxation regimes should be limited to situations of real investments.

**Tax incentives should be based on several cumulative principles:**

- boost **investment in productive capital** (as opposed to a part of the savings and loan);
- encourage the holding of **long duration** instruments (shares; medium- and long-term corporate bonds; instruments invested in these securities), in particular through tax incentives that are progressive depending on the length of detention, based on the assumption that tax rates are set at an acceptably low or moderate level (in order to encourage long-term investments, it would be useful if yields for investors were to correspond to the investment horizon);
- take into account the **risks** associated with relatively risky instruments, such as shares:

  . for similar holding periods, a share should be taxed less than a bond;

  . a bond with a medium or long term maturity should be taxed less than a cash instrument;

  . an illiquid instrument should be taxed less than an equivalent liquid instrument.
- ensure that the after-tax savings incomes are differentiated according to the above principles and are on average higher than inflation;
- be stable or sustainable (last long periods of time), to ensure savers’ trust.

**Several measures should be considered:**

- targeted **saving accounts/products** to supporting the financing of long-term investment projects, while recognising the various existing models for specific savings accounts/products;
- a stable tax and social security regime for savings blocked for some time under a contractual commitment;
- **tax cuts for long investments in shares and bonds**;
- **deduction of an allowance from the capital gains on shares, based on** the **holding periods**;
- a tax credit on dividends for reinforcing the medium or long-term savings of modest-income households; the possibility of opting out of a flat rate tax for a progressive tax scale as regards their capital gains on securities;
- improving existing tax regimes (ceilings, tax cuts) to strengthen the equity financing of SMEs and mid-sized companies;
- a fiscal transparency regime allowing individual investors to deduct their capital losses from their taxable income and to absorb the losses incurred by companies in their start-up phase.

## 3. 3. Facilitating cross-border flows

### 3.1. Removing withholding taxes for cross-border flows of interests and dividends

Withholding taxes on interests and dividends paid to residents of other EU Member States create barriers to cross-border flows between Member States and a segmentation of Europe's Internal Market. A removal of withholding taxes on dividends and interests would facilitate intra-Union trade and the creation of an efficient CMU.

### 3.2. Improving the access to tax treaties' benefits to eliminate double taxation

**Double taxation** is an obstacle to cross border flows. Despite the Tax treaties which aim to eliminate the double taxation, this latter **remains a concern** for taxpayers, as the eligibility to tax treaties benefits is complex. It is often complex and costly for an investor to obtain the tax relief that it is legally entitled to. This leads to disincentivise cross-border investment in capital markets. Moreover, the procedures put in place in order to obtain the reimboursment of withholding taxes can be long, costly and with administrative and practical obstacles.

In order to improve the access to tax treaties' benefits, to eliminate double taxation, and thus to facilitate non-residents investments:

- the tax authorities should provide sufficient guidance to ease treaty access to foreign investors, with simpler rules,
- simplified relief at source procedures should be adopted within the EU: the EU Member States should put in place streamlined, efficient and simple procedures to reclaim excessive whithholding taxes in accordance to tax treaties.

***31) <u>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</u>?***

Under this question, please refer to our response to question 23 as regards **high frequency transactions**, to our response to question 32 as regards **investment management, information and monitoring tools** and to the following as regards **electronic reporting**.

In its Green Paper, the European Commission indicates that more efficient approaches towards supervisory reporting involving national authorities or ESMA could be helpful for market participants, for example in relation to common IT approaches for certain **reporting requirements**.

This statement can be read in the context of the Transparency Directive (TD) as amended in November 2013, which requires listed companies to establish their annual financial reports in a single electronic reporting format (**European Single Electronic Format**, ESEF), with effect from 1 January 2020, provided that a cost-benefit analysis has been undertaken by ESMA. ESMA, which was assigned by the European Commission to prepare the corresponding technical standards by 2016, performed in the summer of 2014 a pre-consultation on the issue, with the aim to identify, evaluate and determine: the technical requirements for the single electronic format; the different technological options for consideration by ESMA when considering the development of this format; a preliminary cost / benefit analysis on the technological options

In response to this pre-consultation, **while recognising the need to implement the Transparency Directive's requirement,** <u>companies</u> continue to highlight the **major concerns related to some technical options that are being considered by ESMA as regards the electronic reporting format**, **due to the far-reaching consequences that it may have on the quality of issuers' reporting and on the liability attached.**

They **<u>are particularly opposed to the introduction of a mandatory reporting format based on a "builtin or integrated" approach, such as XBRL and Inline XBRL</u>, which would lead them to make upstream <u>significant and costly changes</u>[41] throughout their processes and information technology systems, <u>without improving the quality and comparability of their publications</u>.**

They emphasize in this respect the **absence of demand from information users for** an electronic reporting **format based on an integrated approach** and the **difficulties encountered in the United States in the implementation of XBRL**.

Against this background, **the requirement introduced by the Transparency Directive** should provide maximum flexibility in corporate communication and **should not lead to prescribe an integrated approach or a structured electronic format, which would negatively impact their financial communication/disclosures. Indeed, many data in annual financial reports — such as quantitative or narrative data —could not be properly reflected in taxonomies and in reports that would use an integrated approach. This would alter corporate communication, make information understanding and comparability hazardous and pose a serious liability issue for companies.**

**Finally companies should in no way be held responsible or liable for the consequences of using taxonomies that would prove unsuitable or of using a format that eventually would fail to reflect**

[41] Besides significant direct costs (such as costs of tagging each item of data), the use of a taxonomy or of a structured format — such as XBRL or Inline XBRL — involves very high indirect costs relating to overhauling the architecture and content of companies' internai IT applications, even for applications that do not use a structured format (costs related to consultancy, overhauling applications, maintenance and control). Indeed, as most companies' IT systems include interrelated applications, even the partial use of a structured format would imply to review and change ail these systems.

**the substance of their communications.**

***32) <u>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</u>?***

**In our view several issues require action to achieve a Capital Markets Union:**

- **The scope should include action regarding equity funding, the funding of innovation for businesses of all sizes, and mid-sized companies;**
- **The needs of corporates to hedge their risks through derivatives and to have enough liquidity for their shares and bonds should be addressed;**
- **Policy measures should be taken in the short-term to incentivise investments;**
- **The resource allocation process should be enhanced by putting in place investment management, information and monitoring tools.**

- **<u>Scope of the funding issues</u>**: the CMU Green Paper focuses on investors (certain aspects) and intermediaries. However it should **target as a priority: long-term investments (including through equity funding); innovation from companies of all sizes; mid-sized companies and SMEs**.
  - the Green Paper does not specify how it articulates with the 2014 EC **<u>Communication on Long-Term Financing</u>, although long-term financing remains a priority**. The CMU initiative should **not delay measures aimed at supporting long-term investments and the implementation of the European investment plan** ("Juncker plan");
  . it fails to recognize that the funding of **<u>innovation</u>** should be supported for businesses of all sizes (not only for start-ups);
  . it rightly seeks to improve access to finance, notably for SMEs, but in some respects does not sufficiently take into account the role of **<u>mid-sized companies</u>**[42], which are key to the development of capital markets and to the emergence of European companies with a global dimension.
  . it does not sufficiently emphasize the important role of companies in capital markets and their need for **<u>equity</u>** funding;

  Companies need to increase their capital and have a stable shareholder base in order to implement long-term strategies, not be subject to undesirable takeovers and be able to borrow under better conditions from financial institutions or by issuing debt securities. Yet the prudential rules for insurance undertakings and banks significantly increase the impact of macroeconomic factors threatening investment in the shares and bonds of European companies (unfavourable outlook compared with other parts of the world; in a tough economic environment, increase in short-term saving by households - particularly precautionary saving-; competition from sovereign bonds).

[42] Companies with less than 5 000 employees and either a turnover of more than € 50 million and not exceeding € 1 500 million and/or an annual balance sheet total not exceeding € 2 000 million

- **Hedging and liquidity**: the CMU Green Paper focuses on financing and does not sufficiently address the **need of corporates to hedge their** operating and financial **risks** and the **need to ensure greater liquidity in markets**:

  . to manage their risks, corporates need in particular to enter into **derivative contracts** – over-the-counter or not – **at limited cost**;

  . it is necessary to foster the growth and the liquidity of **secondary markets** and thus not to penalize the **market-making activities**[43] **and** the **liquidity contracts** aimed to ensure the liquidity of the securities issued by corporates (shares as well as bonds).

- **Investment incentives**: to meet the objectives of the CMU Green Paper, **policy measures** s**hould be taken to incentivise investments in productive, strategic or innovative projects and to ensure their profitability**, taking into consideration their risks and time horizons. **Five drivers need to be considered in the short-term**:

  . **more favorable tax treatments** (corporate income tax and taxation of savings income): the need to make progress is **more pressing than ever**. The tax treatments associated to financing and savings/investment should foster longer duration and/or less liquid investment into corporate shares and bonds, as well as related funds (including ELTIFs). It seems particularly advisable to **coordinate tax policies and issue EU recommendations**, in order to achieve this objective at EU level;

  . **better risk-sharing**: it is advisable to consider mechanisms that would allow certain investments (e.g. long-term or innovative projects) to benefit from guarantees (credit enhancement, etc.);

  . **exit opportunities and better regulatory treatment for long-term investments**: when developing financing instruments, such as ELTIFs, exit opportunities should be provided to investors. In any case, flexibility is needed to make investments, including long-term investments, more liquid and attractive;

  . **an appropriate or better calibration of prudential requirements**: prudential requirements must be such that they are not unfavourable to banking intermediation and institutional investors[44] - , in particular insurance companies and pension funds, including occupational pension schemes - relative to short-term investors and unregulated players, particularly those from the shadow banking system (SBS)[45]. Otherwise, the general objective of stability would not be achieved and the long-term financing channels would be severely and lastingly affected;

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[43] At the same time taking care to ensure that market-making activities are compatible with the markets'essential long-term financing function.

[44] Prudential rules may inter alia lead to short-term investments replacing long-term ones due to excessive liquidity requirements.

[45] Operators from the SBS are less regulated and more numerous . This would lead to the risk of financing channels becoming longer, more complex and more vulnerable.

. **ensuring market <u>post-trade transparency</u>**: it is essential that the new MiFID II provision to have a consolidated tape and that information be available at reasonable prices be carried through.

- **<u>Resource allocation process, investment management, information and monitoring tools</u>**

Resources must be allocated to the activities with the best future prospects for the EU. The development of alternative financing methods, i.e. other than bank financing – recourse to capital markets, collective investment, private placements, etc. - has been accompanied by a **proliferation of decision centres** and **may lead to projects that are strategic for the EU being financed too late or not at all**.

A political push is needed:

. It is indispensable to have a shared vision of the future of the EU, to **identify and evaluate the projects that are of key importance** to it, and to be able to realise this vision within the framework of an economic policy **based on identified players and management and monitoring tools – particularly statistical ones -**. The stress must be placed on productive investments, and less and less on public debt and real estate;

In this respect, we support the creation of a **central EU-level website to provide links to Member State projects/pipelines** and include EU project information, as suggested by the Investment Task Force Report of December 2014 (e.g. under the Connecting Europe Facility and European Structural and Investment Funds). However we believe that **further analysis should be undertaken to assess whether such website could not be extended to other projects than infrastructure projects**;

. Companies should be provided with clear **information regarding the access to European funds**: many companies remain unaware of eligibility rules, what needs to be done to access European funds and which intermediaries to contact.