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25 June 2013

Afep's Response to the European Commission Green Paper

Long-term Financing of the European Economy

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Transparency Register identification number: ***953933297-85***

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EUROPEAN COMMISSION GREEN PAPER ON LONG-TERM FINANCING

GENERAL SUMMARY OF AFEP's[1] RESPONSE

Member companies are pleased that the European Commission has taken the initiative of starting a broad debate on long-term financing by means of its Green Paper of April 2013. This reflection constitutes an **exceptional opportunity for the European Union to shape a forward-looking macroeconomic approach to strategic challenges**.

1. EUROPEAN AND WORLD CONTEXTS

The Green Paper appears against a European background of **persistent crisis** and difficult economic conditions in which companies, as well as financial institutions and States, many of them heavily indebted, are seeking financing on the best possible terms. Europe's financing requirements **for the coming years are considerable**[2] **and make access to financing an absolute priority for the European Union** (EU).

Fundamentally, this reflection takes place in a global context marked by a **change of paradigm**, characterised by a number of key factors: a) significant **differentials in costs and economic and demographic growth**, to Europe's detriment; b) **starkly contrasting financial capacities**: abundant liquidity in the emerging economies and high levels of public indebtedness in many EU Member States; c) **increasing competition**, not only in the field of innovation and talent but also as regards access to energy, raw materials and financing.

Despite its handicaps, the EU has some major **advantages** it can still rely on: a stable political system; high GDP; significant export capacity at EU level; good research and development capabilities; a skilled workforce; continuing high levels of household savings; a well-developed financial system, etc.

2. THE STAKES AND THE TERMS OF THE EQUATION FOR THE EUROPEAN UNION

For the EU, the long-term strategic priority is to **retain** and **consolidate its position in the world** by putting in place, in the short term, a **virtuous dynamic** for growth and employment. **That involves the EU and its companies developing future projects that are competitive and attractive to investors**, whether European or from further afield. It also involves **promoting the emergence of European companies with a global dimension**.

In this respect, **the financing of productive investment**[3] **is an indispensable spearhead** for future growth and employment. However, **the viewpoint and the reflection, if they are to refer to the long term, must also be strategic,** and focused on maintaining or developing sectors and activities that are of key importance to Europe's economy: **the EU's interests also include short-term financing of strategic projects**.

[1] *Association Française des Entreprises Privées* (French Association of Large Companies)

[2] As an indication, according to a study by Standard & Poor's published in May 2013, the needs of non-financial companies in the euro zone are likely to be between $8.3 and $8.56 trillion for the period 2013-2017 alone. These figures, while not limited to long-term financing needs, nevertheless give an idea of the kind of volumes involved.

[3] Productive investment in industry and services.

3. CONDITIONS OF SUCCESS FOR THE EUROPEAN UNION

The conditions of success for the EU can be classified under four headings:

1. Means and methods of financing;

2. Legislative and regulatory environment;

3. Investments and the resource allocation process;

4. Political foundations.

While the first two points, concerning financing, are at the heart of the Green Paper, the other two are scarcely touched upon. Given that **Europe's financing needs are substantial and the resources limited, these resources should be allocated to the activities with the best future prospects** and, more broadly, the means of ensuring overall coherence and effective management and monitoring of needs and resources should be organised at EU level.

We will now look at each of these four headings in turn:

3.1. MEANS AND METHODS OF FINANCING

The Green Paper notes the prudential reforms adopted or underway, and showcases **alternative**, i.e. non-bank, financing instruments. In a context of **structural shortage of long-term financing**, there can be no doubt that the **diversification** of means and methods of financing is **useful** to companies and that it is **appropriate to facilitate the use or encourage the development of certain financing instruments or channels suited to long-term investors**: corporate bonds, covered bonds, project bonds, long-term investment funds, private placements, etc. In this respect certain existing systems such as Pfandbriefe, Schuldscheine or USPP may serve as references for **defining a suitable European legal framework**.

However **this is not enough: more fundamentally, the general European framework needs to be better adapted to long-term imperatives, taking account of the following five factors in combination, as opposed to separately**: a) **stability**; b) **fairness of the rules**; c) the need to finance **long-term assets**; d) **matching** by long-term liabilities and equity; e) the need to **transform** short-term liabilities into long-term assets **and/or** the need for **liquidity**.

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. **Based on the five factors indicated, it seems to us that the following paths should be taken**:

a) **Europe's prudential reforms must not be unfavourable to banking intermediation and long-term investors - insurance companies and pension funds in particular - relative to short-term investors and unregulated players**, particularly those from the shadow banking system (SBS). **Otherwise, the general objective of stability would not be achieved** and the long-term financing channels would be severely and lastingly affected;

b) **The European legislative and regulatory framework must not be unfavourable to long-term investors from within the EU relative to those from outside the EU**. 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 long-term financing of its economy, **particularly by not taking sufficient account of business models and high liquidity requirements**. Thus for example the United States has deferred application of Basel III and has not adopted the IFRS; the requirements of Solvency II remain confined to the EU. In this context, the timetable for implementing Basel III in the EU and the proper calibration of its prudential requirement are essential to avoid a recessionary spiral;

c) **The long-term financing needs of non-financial companies in the EU are considerable. Taking entrepreneurial risks is indispensable for long-term development**. It is now **imperative to plug the shortage of capital financing, to avoid penalising long-term bank borrowing, and to facilitate the use of bonds**. A number of principles should guide actions in this field: not penalising long-term investments in the prudential rules[4]; facilitating access to the bond markets (creating platforms dedicated to corporate bonds, direct subscription by retail investors, organising liquidity, etc.); developing long-term financing vehicles (LTIFs, etc.) and mechanisms for sharing or covering risks (credit enhancement, etc.); putting in place tax regimes that favour investment in companies rather than in real estate assets[5];

d) **Long-term saving should be encouraged: it is a response to the European demographic challenge and to the need to find long-term resources in order to meet the needs of the real economy**. In channelling these savings, priority must be given to **productive long-term investment**. This notably involves appropriate tax and prudential measures. In particular the prudential rules must not lead to part of long-term savings being switched into short-term due to excessive liquidity requirements, and they must count statistically stable liabilities as long-term;

e) In view of the scale of long-term financing requirements and the difficulty of funding them adequately with long-term resources, **the transformation function is indispensable**. **The major role of the banks in this area must be preserved**, notably in the context of the defining of the long-term liquidity ratio (NSFR) that is underway. It is also important to make the short-term liquidity ratio (LCR) more flexible by including high-quality assets eligible for central banks[6]: indeed, the ECB's monetary policy would be even more effective if the funds deposited with it by the banks as liquidity buffers were used to finance the economy.

   Complementarily, **securitisation** should be given a **European regulatory framework that would improve transformation, while at the same time complying with the imperative of financial stability**. It would also be **useful to provide liquidity for long-term resources on secondary markets** — notably equities and bonds —, **at the same time taking care to ensure that market- making activities[7] are compatible with the markets' essential long-term financing function**.

   We would stress that a reduction in the role of the banks would lead to intermediation and transformation being carried out by operators from the SBS, who are more numerous[8] and less regulated, which would lead to the risk of financing channels becoming longer, more complex and more vulnerable.

3.2. LEGISLATIVE AND REGULATORY ENVIRONMENT

In addition to the prudential rules previously mentioned, the European legislative and regulatory framework comprises a set of provisions concerning markets in financial instruments, information to investors and company law. **It is important for this regulatory framework to attract long-term investors, without discouraging issuers from calling on the markets**.

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[4] Prudential rules may lead to short-term investments replacing long-term ones; see in particular e).

[5] Except for financing energy savings.

[6] 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 are refinanced by companies supported by the government (Fannie Mae, Freddy Mac, etc.)

[7] Market-making activities are often complementary to the issue of securities on primary markets. In the context of a European project for reforming the structure of the banking sector, a reduced capability of European banks to carry on these activities could benefit third-country (notably US) banks that are not subject to the same obligations.

[8] The shadow banking system consists of a multitude of banking and financial operators linked by more or less long and complex chains of financial intermediation.

The introduction in 2007 of legislation on markets in financial instruments (MiF) and the development of technologies have led to a proliferation of order execution systems, fragmentation of markets and liquidity, and growth in automated high frequency trading (HFT). **These developments often seem to be at odds with the essential objectives –** facilitating the financing of the economy - the central role of the markets -, and reducing financing costs, or even likely to deter issuers and investors (particularly long-term ones) from accessing the market. In particular, certain transactions tend to undermine investor equality and to destabilise markets and prices.

The laws and regulations relating to financial information are numerous[9], complex and/or inadequately expressed, and this hinders issuers' access to financing and increases costs. Moreover, in the framework of the IFRS, the use of fair value has pro-cyclical effects and encourages short-termism in investor behaviour.

We believe certain provisions need to be improved so as to favour the financing of the real economy, particularly at long term:

- **legislation on Markets in Financial instruments (MiF)**, currently under revision, must ensure that **financial markets function properly**, particularly the equity and bond markets, the more so as the markets will be called upon to play a more important role than in the past. In particular, legislation should be strengthened so as to improve transparency and reduce the number of highly speculative short-term transactions[10];
- **the structure and content of the laws and regulations relating to investor information should be revised and simplified**, without adding new obligations. In particular:
  - **the IFRS should be made less stringent, and should better reflect companies' business models** (non-financial and financial companies) **and place strict limits on the use of fair value**. To this end, the EU's ability to **influence the process of international accounting standardisation should be strengthened** by: enlarging the role and the resources of the EFRAG, enabling it to act more upstream; including financial stability and economic growth criteria in the adoption of the IFRS; amending the related European Regulation so as to enable the EU to define an appropriate treatment, in exceptional cases where the provisions of the IFRS prove inappropriate despite European actions upstream; taking account of IFRS as adopted by the EU in agreements between the EU and third countries;
  - non-financial information greatly enhances financial analysis. However, **integrating financial and non-financial information further (integrated reporting) would be a source of confusion for investors, and must therefore be avoided**. In fact, once certain accounting provisions are adapted in the IFRS, the financial information, which quite rightly already includes the most relevant non-financial aspects, would be sufficient to show the company's performance; furthermore, non-financial information, which is still incomplete, non-harmonised and inaccurate, often in narrative form, is by and large much less reliable than financial information, and difficult to consolidate;
- company law must allow companies to **promote the establishment of a stable shareholding and the long-term commitment of shareholders**, notably by promoting employee shareholding and being able to **provide in the Articles of Association for double voting rights or extra dividends**, for nominative shares held for at least two years;
- lastly, asset managers should inform their clients of their investment strategies, ensure that they comply with the mandates received and report on their investments, their votes and their form of remuneration.

[9] Directives on Financial statements, IFRS, legislation on Prospectuses, Transparency Directive, legislation on Statutory Audit, etc.

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

3.3. INVESTMENTS AND THE RESOURCE ALLOCATION PROCESS

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[11].**

The EU will be able to resume sustainable growth only if its major productive investment needs are covered, in particular those meeting the needs of economic agents and the following objectives:

- not just staying ahead in innovation and research and development, but also making sure innovations and new technologies are implemented;
- consolidating European export positions, boosting productivity and supporting technological and industrial change;
- ensuring energy independence and supplies of raw materials;
- facilitating and securing the circulation of goods, energy, services and information, by means of appropriate transport, energy and communication infrastructures / networks;
- ensuring health and food safety and protection of the environment.

To ensure that these investments are profitable, we would stress the need for them to meet the structural needs of the population and of the other economic agents (notably companies).

3.4. THREE MAJOR POLITICAL FOUNDATIONS

Public authorities, both national and European, have the task of bridging the structural gap between the supply of financing and the demand for long-term productive investment and bringing the economy back to a dynamic of sustainable growth. This involves three main political foundations:

a) restoring sound and attractive economic fundamentals;

b) adapting the legislative and regulatory framework and tax policies to the demands of investment and long-term financing;

c) defining and implementing an economic and industrial policy.

a) Restoring economic fundamentals to attract liquidity

The EU and its non-financial companies will become more attractive to investors if the public **finances are** consolidated and companies' **competitiveness and self-financing capacity are restored**:

- **reducing expenditure and public 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;

[11] See note 5.

- **corporate self-financing is the inescapable starting point for a virtuous circle of financing and investment**: maintaining companies' self-financing capacity at a high level, as well as facilitating the financing of long-term investments, also enables them to reduce the equity gap, to keep control of innovative activities and to make full use of external financing. In this respect it is essential to avoid increasing companies' tax burden — notably through the introduction of a European Financial Transaction Tax (FTT) — or requiring companies sponsoring pension funds to bolster their capital in accordance with the requirements inspired by the Solvency II Directive (in the context of a future revision of the IORP Directive).

b) Adapting and then stabilising the legislative and regulatory framework/ Coordinating tax policies

As already pointed out, the legislative and regulatory framework must be adapted to companies' business models and to the different long-term financing channels and tools (financing by the markets, intermediated financing[12] or private placements). **The tax treatment of savings must allow these savings to be channelled as a matter of priority into long-term productive investments, and must take account of the need to reward risk-taking**. 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.

Following the necessary improvements, stabilisation of the legislative and regulatory framework and the tax provisions must enable the creation of an environment more favourable to long-term financing — giving investors greater visibility; less complex and onerous for companies —.

c) Defining and implementing an economic and industrial policy

In a context of scarce public resources, the role of the authorities is not primarily to act as investor. However for projects of a strategic nature encountering financing difficulties, it is useful for public institutions[13] to be able to contribute to the financing or the assumption of risk (risk sharing or guarantees).

More fundamentally, **the essential responsibility of the European and national public authorities consists in defining policies based on a forward-looking vision of the EU, prioritising and selecting future investment projects, and ensuring that these projects are financed adequately and in a coordinated manner. Economic policy, which must rely on management and monitoring tools, must take account not just of financing but also of investment, and must go hand in hand with a real industrial policy [14], in tandem with significant potential as regards research and development and innovation. Europe cannot be just a monetary bloc without an investment strategy.**

In this respect 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 also to improve coordination of policies, including tax and social policies. In particular there is a strong interest in arriving at a set of harmonised rules concerning access to financing, the tax treatment of savings, and taxation as it relates to investments and the financing of businesses.

The agreement reached in the summer of 2012 in a new European Growth and Employment Pact signals a common determination which the political authorities must now without fail translate into tangible action. In particular a precise calendar for the next few years should set out in detail the paths that the Member States wish to pursue.

[12] Bank financing and collective investment, particularly.
[13] The European Commission, the European Investment Bank (EIB) and the European Investment Fund (EIF)
[14] The concept of industrial policy covers all economic activity of private sector businesses.

AFEP'S RESPONSE TO THE QUESTIONNAIRE

2. THE SUPPLY OF LONG-TERM FINANCING AND CHARACTERISTICS OF LONG-TERM INVESTMENT

QUESTION 1: Do you agree with the analysis out above regarding the supply and characteristics of long-term financing?

We believe that **the analysis regarding the supply and characteristics of long-term minimises the impact of regulation on investors' behaviour, especially with regards to equity, and does not adequately address the issue of the nature of the assets:**

- The fall in private investments is not only driven by "risk aversion and lack of confidence as a result of the weak macroeconomic situation". There is a deep equity gap in Europe, which needs to be filled in order to soundly finance long-lived capital goods;
- Within the overall challenge of the financing gap, the issue of the nature of the assets should occupy an important place. Indeed, demand for assets considered as safe should exceed supply, which represents a new constraint for the long-term financing of the European economy. Upstream of the regulatory changes underway, this is set to experience a structural hardening as a result of the ageing population, both at European level and globally, and will therefore emerge as one of the major challenges to be met in the years ahead.

The challenges for the European Union and the Member States: to be attractive, active and selective

The main stake for the EU is to remain attractive as an investment destination for all investors. In that respect, **the long-term growth prospects of the European economy depend above all on the ability of public policy-makers to create an economic and fiscal environment that is conducive to investment, in particular long-term investment**.

The Green Paper mainly focuses on **lending vehicles**. Lending vehicles, the financial sector's ability to channel the savings into productive investment and the ability of financial markets to offer long-term financing instruments are **essential, but** alone are **insufficient**.

We believe that:

- the capacity of the economy to provide the financing of long-term investment depends on the ability to generate savings and attract and retain foreign direct investments (FDI).
- various providers can act as the sources of long-term financing, including governments, corporates and households. Long-term savings are a response to the challenges of demographics 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. Appropriate investment instruments must be available to long-term investors.

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

- in a context of weak growth, **to present clear policy guidelines and more favourable prospects** in order to:
  - attract liquidity from zones and countries outside the EU and ensure that the considerable savings which the European Union still has available are invested in the EU as a matter of priority;

. encourage or prompt companies and households to invest over the long term;

- to have an **economic and industrial policy enabling financing to be allocated to the most relevant productive investments** for competitiveness and growth, particularly in the long term;
- **to generate long-term savings** in the European Union, based on the long-term requirements of savers and investors.

<u>The key role of the public authorities in the management of public affairs, economic policy and regulation</u>

In this context, the **role of the national and European public authorities is to address the structural gap between supply and demand for long-term financing, by performing several key functions:**

- not only, as mentioned, « catalyse private financing and help manage the associated risks » and « provide public investment in an anti-cyclical manner »;
- but also, as a prerequisite, **create and maintain an economic and fiscal environment conducive to investment, particularly in the long term,** for European and non-European households and companies;

. **reduce public spending and debt: high public debt is detrimental to growth, increases financing rates and risks, diverts investments from third countries away from the EU and absorbs a very high proportion of financing, particularly in the long term, to the detriment of the financing of the economy (crowding out effect)**, to the detriment of the financing of the real economy;

. **ensure the competitiveness of companies, by preserving or improving their self-financing capacity**[15]

. **Substantial self-financing capacity facilitates raising and/or reimbursing funds, enables to support investment and growth, and generates tax and social security revenue. Yet companies in certain large European economies are experiencing historically low margin levels, which is extremely detrimental to them;**

. **define an economic and industrial policy enabling the EU to maintain a top-tier position globally in high added-value segments:**

* not only by encouraging R&D, innovation and anticipating the energy transition and technological and industrial change;

* but also by ensuring that export sectors benefit from financing conditions which are as favourable as those from which competitors from zones or countries outside the EU benefit.

. **ensure the smooth functioning of the financial markets**, particularly the equity and bond markets;

. **define and implement fiscal policies which steer savings in the direction of long-term investments in the real economy and which take into account the need to remunerate risk-taking**;

. **ensure the appropriateness of the prudential and accounting framework for the**

[15] Self-financing capacity and bank credit are the two main financing methods used by mid-size companies.

requirements of long-term investment and, following a reform along the lines described below, **the stability of the legislative and regulatory framework and fiscal policies**.

QUESTION 2: Do you have a view on the most appropriate definition of long-term financing?

We agree that long-term financing can be considered as the process by which the financial system provides the funding to pay for investments that stretch over an extended period of time and includes sources of financing that have no specific maturity, such as equities.

However we believe that long-term financing should not be too narrowly defined, in particular by reference to specific maturities of financing, such as maturities in excess of five years, according to the work carried out under the auspices of the G20 on long-term investment.

In fact, the structural and/or sectoral changes in the economy, economic cycles and changes in global competitiveness mean that it is sometimes not possible to have visibility beyond a timeframe of two to three years.

At a time when the economic situation is depressed and a major risk of a prolonged recession cannot be ruled out, **there can be no long-term vision without at the same time ensuring the means to finance and carry out activities in the short term**. **This implies financing with short maturities or bank credit lines being opened/maintained under financial conditions which are not detrimental to the banks' customers**. Yet they are seeing a significant increase in bank financing and credit line costs (even if credit lines are not used), due to increased prudential requirements.

3. ENHANCING THE LONG-TERM FINANCING OF THE EUROPEAN ECONOMY

3.1. The capacity of financial institutions to channel long-term finance

Commercial banks

QUESTION 3: Given the evolving nature of the banking sector, going forward, what role do you see for banks in the channeling of financing to long-term investments?

Please refer to the introduction of our response to question 4, concerning the notions of long-term investments and long-term financing needs.

Preserve the maturity transformation role of banks and ensure favourable conditions for companies regarding the use of alternative long-term financing channels

The Green Paper underlines risks associated with making excessive use of leverage and maturity transformation, which are addressed by the European **prudential rules for banks**. 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.

Against this background, 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 that long-term financing requirements remain at a high level, banks have a key role in the distribution of credit and transformation.

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.

<u>**Avoid penalising financial transactions through an accumulation of obligations**</u>

It will only be possible to ensure the satisfactory financing of the European economy and investment in the long term if financial transactions are not subjected to an increase in or a stack of obligations: Financial Transaction Tax (FTT), reform of the structure of the banking sector…

In particular, such obligations would be liable to reduce liquidity on the secondary equity and bond markets and therefore, indirectly, fundraising on the primary markets.

More specifically:

- companies are strongly opposed to the draft Directive proposing the introduction of a **Financial Transaction Tax (FTT)** in a part of the Eurozone. The proposed FTT would undermine the attractiveness of the taxation area, would deeply affect non-financial players and would be contrary to the objectives pursued at European level. It would penalize the financing of the economy, especially over the long term, and the financing operations carried out by companies and groups to finance their activities, to hedge their operations and to manage their funding, their treasury and occupational pensions. This should be avoided:
  - while Europe needs to attract capital and investments and strengthen its competitiveness, this FTT would **undermine the attractiveness** of the taxation area and place its non-financial and financial players at a **competitive disadvantage** vis-à-vis other players;
  - such a tax **would affect the financial sector, but would also have considerable direct and indirect effects on non-financial companies**. The liquidity and prices of their **equity and debt instruments** would be affected, **although they are key instruments for their long-term financing**. **Other financial instruments used by companies to hedge corporate risks**,

to manage the **pensions** of their employees and former employees over the long-term (**IORPs**) and to manage their treasury / liquidity would equally be affected;

. **the absence of exemption from intragroup transactions would further increase the tax burden** and greatly reduce the necessary flow of liquidity within groups (a dedicated undertaking carrying out financial transactions on behalf of a group would generally be regarded as a financial institution and therefore be liable for the tax in respect of each financial transaction with any company of the group).

- special attention should also be given to a **reform of the structure of the EU banking sector and** the **impact it could have on the liquidity of financial instruments issued by companies**, and in particular on the possible consequences of an obligation to assign market-making activities to a trading entity, for European banks and non-banking customers.

  It is argued that the absence of guarantee from the parent company of a universal banking group to such entity would substantially alter its access to funding and its ability to act as counterparty in the interbank market. This could have several adverse consequences for long-term securities issued by corporates:

  - a reduced ability of European banks to participate in market-making activities and in issuances of securities on the primary markets, which are often performed in a complementary manner: this would benefit competing banks from countries that are not subject to the same obligations for market-making activities (US banks or banks from other third-countries);
  - lower liquidity for financial instruments that are issued by corporates (bonds, shares) or commonly used by them to offset market volatility (derivatives, including foreign exchange and / or interest rate derivative instruments);
  - reduced competition and offer of banking services and higher costs of related transactions for corporate customers;
  - more generally, decrease in the profitability of European universal banks and increase in the cost of bank financing, while the latter is particularly important in the European Union (about 80 % of corporate financing).

If, as part of a reform of the banking sector, the capital requirements for European banks were reinforced for certain activities which are considered riskier, lower requirements should be considered for activities relevant to non-financial companies, including long-term financing activities.

National and multilateral development banks and financial incentives

QUESTION 4: How could the role of national and multilateral development banks best support the financing of long-term investment? Is there scope for greater coordination between these banks in the pursuit of EU policy goals? How could financial instruments under the EU budget better support the financing of long-term investment in sustainable growth?

It should first be pointed out that long-term financing requirements do not only cover long-term *investments*, but also existing activities characterised by long production cycles (e.g. aeronautics).

Furthermore, the financing of the long-term economy must necessarily involve maintaining the strong positions acquired by the European Union.

The European Union should take steps to identify the financing needs of long-term cross-border projects or activities critical to its competitiveness and growth and how they are covered. If this

examination shows gaps in financing, these must be dealt with in a coordinated manner at European level, in the framework of a network including not only public actors and development banks, but also banks with a European dimension.

Public intervention can be achieved by offering or contributing to funding and a range of financial instruments, including sharing and/or guaranteeing risks, or by further leveraging and catalyzing private long-term financing.

The priority objectives of long-term financing

Growth will return to Europe only if its financing needs are covered, in particular those that meet the following objectives:

- consolidate the European positions on the export markets, enhance businesses' productivity and assist sectoral changes:

. financing of **projects**/goods with a long-term production cycle;

. financing of **exports**: the financing of exports is key to the European trade balance and competitiveness is a major challenge for the European Union; therefore the EU must offer equivalent conditions to those of competitors from third countries;

. businesses' productive and productivity-enhancing investments;

. assist the process of sectoral changes.

- remain at the leading edge of innovation and R&D, in particular in the fields mentioned below;

- ensure the implementation of innovation and new technologies (deployment of numerical technologies…);

- ensure the energy independence and the supplies of raw materials:

. large-scale renewable energy projects;

. energy and resource efficiency; recycling of raw materials; eco-innovation technologies.

- facilitate and secure free flow of goods, energy and services through appropriate transport, energy[16] and communication infrastructures / networks; ensure the protection of these infrastructures;

- ensure health and food safety, as well as environmental protection.

<u>QUESTION 5: Are there other public policy tools and frameworks that can support the financing of long-term investment?</u>

As mentioned in our response to question 4, public intervention can be achieved by offering or contributing to funding and a range of financial instruments, including s**haring and/or guaranteeing risks**, or by **further leveraging** and catalysing private long-term financing.

[16] 1 600 Md€ by 2020 according to the European Commission.

Institutional investors

QUESTION 6: To what extent and how can institutional investors play a greater role in the changing landscape of long-term financing?

The constraints on the loans granted by the banks should lead to the development of financing by institutional investors.

The context: the possible impacts of the prudential rules applicable to insurance companies

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, and there are plans to reform the rules governing pension funds (IORP II; please refer to our response to question 7)**.**

With regard to insurers, at the very least we are seeing a resource reallocation, leading to reduced investments in shares and a rebalancing in favour of corporate bonds (rather than sovereign bonds). However, the reallocation of investments in shares in favour of bonds is, in particular, linked to interest rate trends (as a rise in rates affects the value of fixed-rate bonds), which are in turn linked to monetary policies, and therefore to the outlook for growth, employment and inflation.

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 a deterioration in solvency ratios, namely volatile and uncertain or weakened equity markets, low interest rates, uncertainty over taxation, Basel III prudential rules and uncertainty over sovereign debt, threatening significant bond investments.

Better calibrate the prudential rules which apply to insurance companies

Against this background, **it is essential to review the prudential rules for insurance undertakings (the Solvency II Directive) to ensure that they do not affect the long-term financing ability of insurance companies and allow them to invest more in shares and private bonds (issued by corporates or banks)**.

In the implementing measures being prepared, the adjustments should be performed in such a way that regulatory asset risk capital charges do not weigh on the holding of long-term assets.

Furthermore, it would be 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.

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 the liquidity thereof in order to cover redemptions.

Also avoid the adverse effects of the rules which apply to banks and pension funds

It is also important:

- not to affect the role which pension funds (IORPs) play in the long-term financing of the economy through an unsuitable reform (please refer to our response to question 7);
- 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.

QUESTION 7: How can prudential objectives and the desire to support long-term financing best be balanced in the design and implementation of the respective prudential rules for insurers, reinsurers and pension funds, such as IORPs?

Please see our response to question 6 as regards the **prudential rules for insurance undertakings**.

As regards the **prudential rules for IORPs**, companies welcome this question and sincerely hope that there is an opportunity here to resume the debate about the IORP Directive on completely new grounds.

The European Commission (EC) recently decided to postpone any legislative proposal about solvency rules for occupational pensions, and to focus the forthcoming revision of the Directive on governance and transparency issues instead. Companies are committed to work constructively on these issues, provided that the proposed legislation is proportionate and appropriate for occupational pensions, and not simply derived from insurance regulation.

Yet, **in the longer run, companies are still concerned that the European Commission did not completely drop the idea of adapting the first pillar of Solvency II to pensions**, although the many shortcomings and the tremendous cost of this approach were made obvious in EIOPA's Quantitative Impact Study. This could have a negative impact on the long-term financing of the economy.

It would not make sense that the prudential regulation for IORPs is derived from Solvency II.

It has been mentioned by many stakeholders (governments, trade unions, employers…) that the project to align the prudential regulation of IORPs with Solvency II stems from a deep misunderstanding of the role and nature of pension funds. Although they may offer seemingly similar benefits, an occupational pension arrangement differs substantially from an insurance policy and the principle "same risks, same rules" is not relevant. Thus there is no need for a "level playing field" between occupational pensions and the insurance industry.

- Pension schemes are not-for-profit institutions for Human Resources policy, which implement occupational arrangements on behalf of their sponsoring employer and its employees and only carry the risks that are necessary to fulfil the pension promise at best cost;
- Pension schemes have joint governance bodies, where beneficiaries have a say in strategic decisions;
- The vast majority of pension schemes are solely dedicated to their sponsoring employer and its employees, have no commercial activities on competitive markets and thus are no competitive actors of the insurance industry.
- Pension schemes are collective vehicles, with mechanisms to share and mitigate these risks between all stakeholders (employer, actives, retirees, pension protection scheme…).

  In most European countries, pension schemes are managed jointly by employers and

beneficiaries, which are not clients. The pension arrangements are continuously negotiated between social partners, obviously evolve over time and include important risk-sharing features, which are extremely difficult to model and to value on a market basis:

. possibility to amend contributions paid by employers and employees;

. possibility to reduce benefits (Netherlands);

. unlimited last resort guarantee from the sponsoring employer (UK, Belgium, Germany);

. national safety net sponsored by all pension schemes (UK, Germany)…

Actually it would not make sense that prudential rules are set for IORPs before any political decision is made about their role in the overall pension system and in the economy of the European Union. The starting point of the debate should be the principles stated in the White Paper "An Agenda for Adequate, Safe and Sustainable Pensions" and the Green Paper on "Long-Term Financing of the European Economy".

Offering a pension promise is a bet on the future of the economy, and there are anyhow risks involved. The issue is then to find the right balance between affordability and safety of the pension system, so that:

- a growing portion of the European population gets a decent retirement income
- the costs of the reform do not weigh too much on the economy and the younger generations

The challenges are the following ones:

- First pillar pensions will be limited by the scarcity of Member States resources;
- Occupational pensions must then form a growing part of European pension systems;
- Occupational pensions are costly, and resources of employers and members are also limited.

Imposing additional capital requirements to IORPs would not be the right way forward:

- Sponsoring companies already face difficulties in accessing long-term financing, and should invest the capital they hold to develop their business rather than freeze in pension funds the capital that is needed today for private and public investment purposes;
- In most European countries, benefits of retirees cannot be altered, so the cost of the reform would mainly be borne by the younger generations through an increase of their own contributions;
- As pension contributions are most often tax deductible, some further strain would be put on public finances in the European Union;
- Member States have already developed their own security mechanisms, which are fully integrated in their overall pension and social system and offer the required level of safety and flexibility (funding regulation, sponsor support, pension protection schemes…).

QUESTION 8: What are the barriers to creating pooled investment vehicles? Could platforms be developed at the EU level?

As mentioned by the EC, there have been a number of initiatives in some Member States with respect to pooled vehicles, and any EU initiative would certainly be welcome.

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. There are **no obvious barriers to their development, with the possible**

exception of prudential requirements.

As long-term investors, **pension funds have limited liquidity needs and are also able and willing to hold illiquid assets**, provided that the prevailing regulation allows them to do so.

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.

QUESTION 9: What other options and instruments could be considered to enhance the capacity of banks and institutional investors to channel long-term finance?

The key role of the banking maturity transformation

As mentioned in section 2 of the Green paper, the financing of the economy will be crippled by a structural lack of long-term resources. Indeed, in all developed economies, the market of savings faces an **imbalance between:**

- **on the supply side: households that are net providers of savings, with a preference for liquidity and safety;**
- **on the demand side: non-financial corporations and general government needs that request long and risky financing.**

Beyond their role as financial intermediaries, **banks play a fundamental role in correcting this imbalance, 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.

The impacts of restricting, and increasing the cost of, bank credit

In this context, restricting bank credit for companies and/or increasing its cost as has been noted 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.

The current situation is already characterised by credit tensions (financing of long-term projects or exports, especially when these are denominated in US dollars) 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.

European banks have started 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 requirements. This includes activities such as infrastructure investments (project and export finance), lending to SMEs, mortgage lending and lending to public entities such as municipalities. For example, it will be less economically viable for banks to finance large scale infrastructure projects.

As a result, it is essential:

- on the one hand, to minimise the impacts of the Basel III agreements (B III) and sovereign debt tensions on the financing of companies,

- on the other hand, to facilitate the use by companies of instruments in addition to bank financing.

<u>**Minimise the impacts of the Basel III solvency and liquidity rules on the financing of companies**</u>

- 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[17] 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

[17] 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.

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 be 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 American situation** where around 50% of outstanding mortgages are refinanced thanks to US government-sponsored enterprises (Fannie Mae, Freddy…).

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 BCE is left with hardly any leeway apart from deciding to sterilize a more or less large quantity of these liquidities.

. In this respect, the transformative role of banks, which is their core business, must be preserved: **like the liquidity coverage ratio (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 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.

To ensure a balanced financing of the European economy (progressive decrease of the bank financing and in parallel increase in the financing by capital markets) **the European Commission, which is bound to produce a delegated act to implement the LCR no later than June 2014, should include into the liquidity buffer the high quality assets that are eligible to central banks and which are a sound financing means of the real economy**.

Facilitate the use by companies of instruments in addition to bank financing

In addition to securitization, covered bonds and project bonds (please refer to our responses to questions 11, 13 and 14), it is useful to **develop the possibilities of private placements**.

Private placements 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 the German model of Schuldscheine or to the U.S. model of private placement (USPP – US Private Placement)**.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.

The combined effects of regulatory reform on financial institutions

QUESTION 10: Are there any cumulative impacts of current and planned prudential reforms on the level and cyclicality of aggregate long-term investment and how significant are they? How could any impact be best addressed?

The cumulative impacts of prudential reforms

The **prudential environment** of all institutional investors in Europe is deeply and quickly changing, 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 - and contributed to depress share prices and stock indices in Europe.

As regards equity and debt financing, 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 banks or by issuing debt securities. Yet 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 which feeds the current financial crisis**. As they have to raise huge 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.

Much has been said already about the negative side-effects of such “pro-cyclical” regulation, especially by OECD. These cumulative impacts are certainly huge in Europe, and partly explain why European equity markets have not recovered yet and are now lagging behind their American counterparts.

<u>**How to address the cumulative impacts of prudential reforms**</u>

To address the issues mentioned:

- current 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 (see our response to question 9);

In particular, it is necessary to **avoid prudential rules leading to some long-term investments being moved to short-term investments**, for example:

- by ensuring that the Basel III liquidity rules do not encourage financial institutions, which are traditionally major distributors of life assurance policies and retirement products, invested in long-term assets, to first steer their clients in the direction of banking products deemed equivalent to deposits;

- by avoiding significant outflows from long-term investments (particularly life assurance) which, if this were anticipated or were to occur, would probably prompt financial institutions to reduce the duration of their assets or increase the liquidity thereof in order to cover redemptions.

- the planned prudential reform concerning IORPs (IORP II) should be postponed and fully redesigned to avoid similar negative effects and not to add further pressure on long-term financing (see our response to question 7).

With regard to the revision of the IORP Directive, the Quantitative Impact Study (QIS) preliminary results released on 9 April 2013 clearly show 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. So the European Commission needs to be extremely cautious about the impact any new prudential framework for pensions may have on long-term financing of the real economy in Europe.

<u>**The cumulative impacts of regulatory reforms should also be addressed**</u>

The cumulative impacts of current and planned regulatory reforms on non-financial companies and long-term financing should also be addressed, with a view to facilitate 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 and increase the cost of hedging financing instruments.

General stability and fairness considerations

Finally, regardless of the nature of the obligations (prudential, regulatory, fiscal), 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 investment in Europe**, by ensuring that the obligations which apply to them are not more restricting than those which apply in third countries.

It should be highlighted in this regard that the Basel III rules, which are transposed in the European Union by the CRD IV Directive and Regulation, are not universally applied, and that the Solvency II rules only concern European insurance undertakings.

3.2. The efficiency and effectiveness of financial markets to offer long-term financing instruments

QUESTION 11: How could capital market financing of long-term investment be improved in Europe?

The range of instruments offered is an important factor to improve capital market financing of long-term investment in Europe.

However, **as a prerequisite, well-functioning capital markets and infrastructures are needed to channel long-term finance and, from the perspective of issuers, much progress remains to be done in this respect**.

A prerequisite: well-functioning capital markets

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 (50% in the United States). 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 revision of the MiF legislation proposed by the Commission, in particular to enhance transparency and information efficiency and enhance requirements to reduce short-term and speculative trading activities. However further efforts are needed to contribute to the swift adoption of the pending legislation.

The fragmentation of markets and liquidity should be compensated for by greater pre- and 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. It is necessary 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.

The reports on the draft Directive and Regulation on Markets in Financial Instruments that were adopted by the European Parliament in 2012 go in the right direction, especially with regard to pre-trade transparency and HFT. However, the agreement in the Council seems difficult to achieve, for example with regard to pre-trade transparency and the establishment of a European database of consolidated post-trade data would be delayed. 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.

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.

Facilitate the use of certain market instruments: plain-vanilla or specific bonds and securitisation

As regards the instruments offered, measures could be taken to improve the capital market financing of long-term investment:

- **corporate bonds**;
- **securitization;**
- **project bonds;**
- **covered bonds.**

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 in shares. **We are of the opinion that several avenues should be taken in order to support** this trend and **further open up the bond markets, by improving how they operate**:

- ensure the transparency of the bond markets and greater visibility concerning issues;
- encourage the establishment of dedicated bond platforms;
- ensure their liquidity;
- facilitate the subscription of bonds by individuals, particularly through more attractive taxation (direct subscription or in the form of UCITS).

Corporate loan securitization, concerning in particular loans to SMEs and intermediate-sized companies, should be developed, while seeking the right balance between financial stability and the need to improve maturity transformation (please also refer to our response to question

14).

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 (see additional comments in response to question 14).

Project bonds: 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**[18]. **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).

Covered bonds: please see our response to question 13.

Ongoing initiatives to better regulate high-frequency trading

Above and beyond draft European legislation relating to financial instrument markets, **we would like to highlight several recent initiatives taken at European or national level, regulating or aiming to better regulate high-frequency transactions**:

- at European level, the Liikanen report proposes in particular:

. to assign to a legally separate entity ('trading entity'), within banking groups, the riskiest parts of trading activities and where risk positions can change most rapidly, if these activities amount to a significant share of a bank's business: proprietary trading (on securities, derivatives…), all assets or derivative positions incurred in the process of market-making, loans to hedge funds, Structured Investment Vehicles (SIVs) and other such entities of comparable nature, as well as private equity investments;

. to reinforce certain capital requirements (more robust risk weights and more consistent treatment of risk in internal models...), concerning in particular assets held for trading and real

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

estate lending.

- in France:

  . certain high-frequency transactions have, since 2012, been subject to taxation at the rate of 0.2%;

  . the law on the separation and regulation of banking activities, on the one hand would prohibit the performance of taxable high-frequency trading operations by subsidiaries dedicated to performing certain speculative activities, and, on the other hand, would require stock exchanges to take measures, particularly price measures, to limit the number of unexecuted orders.

- in Germany, the Bundestag adopted a law at the end of February 2013 intended to regulate high-frequency stock exchange transactions (scheduled to come into force mid-2013):

  . this law provides for the following in particular: the requirement for traders to have a licence and to configure their systems so as to avoid chain reactions on the market, a tax penalising excessive use of this practice, and increasing the market regulator's information and intervention rights;

  . however, it does not provide for the introduction of a delay for orders (to which Deutsche Börse was opposed).

- outside of Europe:

  . in the United States:

    * there are plans to submit these transactions to a tax of 0.3% (Harkin/De Fazio bill) and increase their supervision;

    * with this in mind:

      - the CFTC is scrutinizing a range of high-speed trading practices to assess the impact on US futures markets and investors, and whether traders are routinely manipulating markets by illegally acting as buyer and seller in the same transactions;

      - at the beginning of 2013, the SEC joined forces with the FBI to create a quantitative analysis unit made up of mathematicians and computer engineers responsible for tracking abuses caused by high-frequency trading, particularly by analysing algorithms.

  . the Australian stock market regulator is in favour of introducing a half-second delay for orders.

QUESTION 12: How can capital markets help fill the equity gap in Europe? What should change in the way market-based intermediation operates to ensure that the financing can better flow to long-term investments, better support the financing of long-term investment in economically-, socially- and environmentally-sustainable growth and ensuring adequate protection for investors and consumers?

Strengthening companies' equity should be a priority for the reasons outlined in the response to question 10.

In this response, we highlighted the negative impacts of the current and planned prudential reforms on the holding of shares and, in the response to question 11, the risks arising from the expansion of High-Frequency Trading.

We also indicated the many factors affecting investment in shares in the response to question 10. **Filling the equity gap implies a set of actions, in particular**:

- reassess and address the impacts of the current **prudential reforms** concerning insurance

undertakings and banks; anticipate those of the planned prudential reform concerning IORPs to avoid similar negative effects;

- avoid or strictly regulate short-termist approaches (cf. response to question 11);
- ensure **attractive taxation, at national and European levels**, in contrast to short-term investments and sovereign bonds (cf. response to question 17);
- adopt economic and fiscal policies enabling companies to maintain or restore their **competitiveness**;
- if applicable, promote the establishment or development of **long-term investment vehicles**, such as pension funds.

QUESTION 13: What are the pros and cons of developing a more harmonised framework for covered bonds? What elements could compose this framework?

The development of covered bonds 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).

QUESTION 14: How could the securitization market in the EU be revived in order to achieve the right balance between financial stability and the need to improve maturity transformation by the financial system?

While promoting the development of corporate loan securitization, concerning in particular loans to SMEs and intermediate size companies, four main courses of action should be pursued at national and European levels to achieve the right balance between financial stability and the need to improve maturity transformation:

- **clearly identify and value securitised assets; differentiate between them depending on type and the risks they entail, favouring low-risk underlying assets;**
- **construct a European regulatory framework ensuring transparency of securities and securitised assets, and presenting the guarantees and security required for investors;**
- **ensure that structuring and transaction fees are reasonable;**
- **strictly regulate resecuritisation operations;**
- **submit securitisation markets to appropriate data transparency and oversight.**

3.3. Cross-cutting factors enabling long-term saving and financing

QUESTION 15: What are the merits of the various models for a specific savings account available within the EU level? Could an EU model be designed?

The various existing models for specific savings accounts should be recognized.

In order to encourage long-term investments, it would be useful if yields for investors were to

correspond to the investment horizon.

Taxation

QUESTION 16: What type of CIT reforms could improve investment conditions by removing distortions between debt and equity?

Taxation is not the only criterion determining the choice by a company of how to finance its investments. However taxation may have an impact on its financing cost and thus interfere with that choice.

In some countries, debt-related taxation is more favorable than that applicable to capital funding, as only the interest generally is deductible from taxable income (at least partly).

It is not desirable to challenge the deductibility of interest, which is a real burden on companies. However, it would be desirable to introduce a mechanism that would enable to reduce the tax distortion affecting capital financing. In particular it is useful to consider the introduction of a system that would allow the deduction of a notional interest attributable to the company's equity, like under schemes existing in several European countries (Belgium, Italy, the Netherlands).

QUESTION 17: What considerations should be taken into account for setting the right incentives at national level for long-term saving? In particular, how should tax incentives be used to encourage long-term saving in a balanced way?

Investment in companies' equity should be supported by an attractive taxation regime (see above). However this attractive regime should be limited to situations of real investments.

Furthermore, taxation is an essential tool for guiding household savings into long-term financial products. Public authorities must adapt tax incentives to mobilize savings for long-term investment and the holding of shares and corporate bonds.

These 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;
- take into account the risk 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 to supporting the financing of long-term investment projects;
- 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;
- for shares, the deduction of an allowance from the capital gains, 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;
- a fiscal transparency regime allowing individual investors to absorb the losses incurred by companies in their start-up phase.

QUESTION 18: Which types of corporate tax incentives are beneficial? What measures could be used to deal with the risks of arbitrage when exemptions/incentives are granted for specific activities?

Please see our response to question 16.

QUESTION 19: Would deeper tax coordination in the EU support the financing of long-term investment?

One may regret the absence of a common political vision at European level in the field of taxation. In particular 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.

The financing of long-term investment would benefit from a close coordination of fiscal policies based on the principles developed in our response to question 16 above.

Also it would be worth considering the availability of specific vehicles at the EU level to mobilise greater long-term savings.

Accounting principles

QUESTION 20: To what extent do you consider that the use of fair value accounting principles has led to short-termism in investor behaviour? What alternatives or other ways to compensate for such effects could be suggested?

Description of the EU system and background

The 2002 European Regulation on International Accounting Standards requires listed companies to apply the international accounting standards for their consolidated accounts.

Since the implementation of this regulation in 2005, the IFRS have been amended frequently and profoundly, mostly due to a programme of convergence with the US standards. Further significant and often much debated changes are planned relating to major issues affecting all types of undertakings (industrial and commercial companies; banks; insurance companies), particularly in relation to revenue recognition, leases, financial instruments and insurance contracts.

Despite the efforts made, in 2012 the United States decided not to require or authorise the use of

the IFRS by US issuers.

Description of the fair value accounting principles

Concerning financial instruments, IFRS require that all financial assets, all financial instruments held for trading and all derivatives be measured at fair value.

A financial asset is measured at amortised cost only if both of the following conditions are met:

- the asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding (interest that represents the time value of money and the credit risk).

IFRS 9 Financial instruments, provides options to designate financial assets and financial liabilities at fair value, when doing so eliminates or significantly reduces a measurement or recognition inconsistency ("accounting mismatch").

Also, under IFRS, companies sponsoring pension plans book a net provision to account for their funding deficit. This provision is treated as long-term debt by analysts and rating agencies.

- Pension assets are valued at market price, which is in line with general practice for statutory or prudential purposes;
- Pension liabilities are valued by projecting expected benefit outflows, and discounting them back using a market rate on "High Quality Corporate Bonds".

The use of fair value accounting principles has procyclical effects

The use of fair value implies the existence of liquid and efficient markets or, if applicable, the capacity to value it based on external data or unobservable inputs. However, a valuation based on these principles may lead to high volatility of the valuations, lack relevance in terms of the undertaking's business model and be a source of risks, particularly in the following cases:

- absence of efficient or liquid markets, either permanently or in tight situations;
- absence or heterogeneity of market data;
- complexity of the instruments.

During the boom that preceded the financial crisis, results based on fair value led to increased shareholders' equity and enabled distributions of results based on instant market values. This was instrumental in maintaining and promoting risk-taking by the actors in question, due to an apparently stronger capital base and the prospect of seemingly risk-free gains. Furthermore, the apparent strengthening of the value of guarantees, as a result of the financial bubble, was instrumental in the credit risk being underestimated, fuelling the property and financial bubbles.

In contrast, during the crisis, the interaction of the IFRS with the prudential standards prompted financial institutions to want to reduce their risk exposure considerably, and acted as a reverse amplifier: borrower defaults led to a trend of selling assets, a fall in their values to levels often below their real value, the illiquidity of certain assets and a crisis of confidence between financial institutions.

The use of fair value accounting principles leads to short-termism in investor behaviour

The purpose of fair value is to determine the value of a part of the undertaking at any time, primarily in order to meet the instant valuation expectations of certain investors. It increases the volatility in the financial statements considerably, and deviates from the principle of prudence:

- fair value variations are recognised in profit and loss or, if they are excluded from it, in comprehensive income[19] which, moreover, may create confusion for users of financial statements.

  With regard to financial instruments, the induced volatility would be even greater given that the criteria to be met for amortised cost accounting (SPPI) appear restrictive and would therefore prompt undertakings to recognise a large proportion of their financial assets at fair value;

- furthermore, the use of fair value leads to unrealised gains being recognised in certain parts of the balance sheet:

  . for the assets, by taking into account all the instant variations and, if applicable, the unrealised gains, contrary to the principle of prudence;

  . for the liabilities, by requiring unrealised gains to be recognised in the event of the issuer's own credit risk deteriorating, which produces counterintuitive results.

Concerning **pension liabilities**, as they are extremely long, their accounting **value is highly sensitive to changes in discount rates**. These changes in value (actuarial gains and losses) are directly recognised in equity, and heavily impact the main financial ratios of the reporting entity.

Such shocks in equity are obviously enhanced by the reference to a "market rate" and by the current low yield environment. Eventually, some sponsoring companies have seen their equity wiped out and were either downgraded or forced into recapitalisation. Yet nothing really changed with their pension commitments, it is exactly the same benefits they will pay in the end. Volatility is only driven here by fair value accounting.

Finally, the use of fair value tends to blur the interpretation of the results of the strategy of long-term investors (e.g. insurance companies) and promote the adoption of procyclical behaviour by them.

The current "amortised and/or depreciated cost" approaches have been tried and tested in Europe and have provided very useful support for the growth of its economy, but are regularly undermined by the IASB's proposals aiming to extend the use of fair value.

[19] Fair value changes are recognised in profit or loss, with the following exceptions:
- IFRS 9 allows an irrevocable election to recognise in other comprehensive income (OCI) changes in fair value for equity investments that are not held for trading;
- when the option to designate a financial liability as measured at fair value is used, the entity is usually required to recognise in OCI the change in fair value arising from changes in the issuer's credit risk.

To compensate for short-termism in investor behaviour, actions are needed at the level of the IASB. This also implies that actions are taken at European Union level. We suggest the following:

- **at the level of the IASB:**

. incorporate the objective of financial stability and the notion of long-term investor into the IASB's conceptual framework;

. ensure the stability of the IASB's reference framework to the full extent possible;

. make the following amendments, however, in the IASB's conceptual framework and standards:

* reintroduce the concepts of prudence and reliable information;

* define those cases where fair value can be used, taking into account the specific characteristics of the elements to be valued and the limitations of the markets. The use of fair value should only be contemplated for instruments traded on liquid markets.

. better understand, in measuring performance and valuation methods, the business models, backgrounds and management methods of undertakings (particularly in the long term) and the possible interaction between assets and liabilities.

In particular:

* in most cases, performance should be measured based on cash flows, the predictive value of which is often better than that of fair value;

* the reduced volatility of a portfolio dedicated to financial investments held on a medium-term/long-term basis should be reflected, by providing for a specific accounting category, valued at historic cost, depreciated if applicable on the basis of the value in use, any impairment being recognised in profit and loss;

* it should be possible to value holdings at historic cost (depreciated if applicable).

Finally, the IASB should be encouraged to move in this direction by calling on it to considerably extend, intensify and accelerate the initial efforts made:

- even though this approach still needs to be improved, we would welcome the adoption by the IASB of a financial assets provisioning model no longer based on realised losses, but on expected losses, in order to reduce the procyclical nature of the IFRS;
- the option of recognising value changes in respect of shares in the shareholders' equity is a move in the right direction, but it is regrettable that this option is irrevocable and the income from the sale of securities has to remain in the shareholders' equity, which does not enable the real performance of the investment to be measured (the share financing charges being recognised in profit and loss).

- **to implement the changes needed in the IFRS, the European Union's ability to influence the international standardisation process should be increased, by giving it the effective means to have greater impact with regard to the IASB's conceptual framework and standards.**

This requires action in the following areas in particular:

. strengthening the role and resources of the EFRAG, enabling the EU to act further upstream;

. including EU financial stability and economic development criteria in the criteria which it applies for the adoption of the IFRS;

. ultimately, amending the European regulation giving the EU the capacity to define appropriate

accounting treatment in those exceptional cases where the provisions of the IFRS prove to be inappropriate, despite the actions carried out upstream by the EU;

. in the EU's agreements with third countries, taking into account the IFRS standards adopted by the EU, rather than the standards published by the IASB.

- **as regards in particular pension liabilities, there is at least a need that market regulators reconsider the definition of "High Quality Corporate Bonds", in order to minimise the undesirable impacts and volatility of the current approach**. The question is whether "market" valuation is appropriate for pension liabilities, which are essentially non-marketable, illiquid and long-term commitments. Other approaches are available which would be more suitable, like using a smoothed or a fixed discount rate.

Corporate governance arrangements

QUESTION 21: What kind of incentives could help promote better long-term shareholder engagement?

The Commission puts forward two options, i.e. increased voting rights or dividends for long-term investors. The *"Reflection group on the future of EU company law"* report recommends that companies' articles of association should include preferential rights to promote long-term share ownership[20].

French law already allows these options in the form of granting double voting rights or higher dividends. These widely used mechanisms work as follows:

Double voting right:

Provided it is stipulated by the articles of association, a double voting right is granted to any shareholder who satisfies a minimum shareholding period (at least 2 years, with the option of setting a longer period), subject to proof of being registered throughout this period[21]. This does not therefore call into question the principle of equality of shareholders.

In dispersed shareholding companies, the double voting right is primarily designed as a loyalty bonus and a way of encouraging shareholders to register their shares, which enables the company to know them better. This is strategically important in companies with a family or entrepreneurial shareholding structure, because it reinforces control of the shareholding structure, which accommodates and supports the company's financial and industrial strategy where necessary.

Consequently, far from being a factor disrupting the financial markets, it therefore provides listed companies with the **stability** they need for **medium and long-term management**.

[20] "Companies' Articles should be allowed to provide for long-term shareholders' preferential treatment. These benefits consist of: a) Enhanced voting rights b) Higher dividends."

[21] In the case of registration in a nominal register, the shareholder is identified by the issuing company. A distinction is made between pure registered shares, where the securities are administered by the issuer, and managed registered shares, where the registered securities are entrusted by the holder to a custodian account keeper.

Higher dividends:

Companies wishing to reward their loyal shareholders have the option of adding a clause to their articles of association stipulating that any share registered in the same holder's name for a specified period is entitled to a higher dividend than the dividend paid to the other shares. To avoid any abuses, payment of this higher dividend is subject, in particular, to the following conditions:

- only those shareholders who have held their shares registered for at least two years at the end of the financial year and who still hold them in this form on the dividend payment date can benefit from this measure;
- the higher dividend rate which must be stipulated in the articles of association cannot exceed 10%;
- in companies whose equity securities are admitted to trading on a regulated market, the number of securities entitled to the higher dividend cannot exceed 0.5% of the company's capital for the same shareholder.

It should be pointed out, however, that these two mechanisms mostly have an incentive effect on individual shareholders, since institutional investors and asset managers are reluctant to convert their securities into registered shares.

Apart from these two mechanisms, employee share ownership also plays a part in increasing the proportion of shareholders with a long-term outlook. Consequently, Afep supports the European Commission's objective, as featured in its action plan on company law and corporate governance, of creating a favourable environment for the development of employee share ownership. Indeed, employee share ownership is an important means of promoting group motivation and cohesion, because it increases the feeling of belonging to the undertaking, regardless of the country in which the employees work, and increases their involvement, particularly for those employees who are based some distance away from the headquarters.

QUESTION 22: How can the mandates and incentives given to asset managers be developed to support long-term investment strategies and relationships?

With regard to fund managers, they could be required, in particular, to:

- draw up a report on the investments made;
- disclose their voting policy and how votes have been exercised ex post. The format of this report could, among other things, take the form of a detailed report for each issuer, a summary of the resolutions, or details about the resolutions they voted against. Finally, if investors decide not to vote, they should indicate this in their voting policy;
- disclose the remuneration policy for portfolio managers and, in particular, the base criteria for the variable portion of this remuneration, so as to enable clients to check whether it also includes long-term aspects;
- report the turnover relating to the portfolio managed throughout the year and the fees pertaining thereto;
- indicate whether the manager has invested personally in the funds he or she manages.

<u>QUESTION 23: Is there a need to revisit the definition of fiduciary duty in the context of long-term financing?</u>

With regard to the fiduciary duties of asset managers, they should be required to inform their clients about the investment strategies and ensure that these match the investor's profile throughout the mandate.

Information and reporting

<u>QUESTION 24: To what extent can increased integration of financial and non-financial information help provide a clearer overview of a company's long-term performance, and contribute to better investment decision-making?</u>

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:

1. Financial information cannot be sufficient to reflect the long-term performance;
2. The principles applicable to non-financial information are consistent and have reached the same level of maturity than those applicable to financial information;
3. The principles applicable to non-financial information enable to reflect a long-term performance.

As none of these conditions appears to be met, **we consider that <u>increased integration of financial and non-financial information should be avoided. Such integration cannot provide a clearer view of a company's long-term performance and contribute to better decision-making</u>**.

1. <u>Financial information may be sufficient to reflect the long-term performance</u>:

- **The adaptation of certain accounting rules, in particular of IFRS, should be the preferred route** (please refer to our response to question 20); 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 -;
- **However it would not be possible to foresee a systematic integration of non-financial information**. It is common for companies – in particular the largest – to publish **environmental and social information**, either voluntarily or under a legal obligation, as in France. This information **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**, as this information is not comprehensive and often qualitative.

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

3. **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 capital (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...)...

QUESTION 25: Is there a need to develop specific long-term benchmarks?

We agree with the Commission analysis that quarterly reporting generally creates the wrong incentives and therefore welcome its proposal to lift the obligation for quarterly reporting. The decision to publish quarterly reports should be left to companies.

3.4. The ease of SMEs to access bank and non-bank financing

QUESTION 26: What further steps could be envisaged, in terms of EU regulation or other reforms, to facilitate SME access to alternative sources of finance?

No comment.

QUESTION 27: How could securitisation instruments for SMEs be designed? What are the best ways to use securitisation in order to mobilise financial intermediaries' capital for additional lending/investments to SMEs?

Please refer to securitization in our response to question.

QUESTION 28: Would there be merit in creating a fully separate and distinct approach for SME markets? How and by whom could a market be developed for SMEs, including for securitised products specifically designed for SMEs' financing needs?

No comment.

QUESTION 29: Would an EU regulatory framework help or hinder the development of this alternative non-bank sources of finance for SMEs? What reforms could help support their continued growth?

No comment.

QUESTION 30: In addition to the analysis and potential measures set out in this Green Paper, what else could contribute to the long-term financing of the European economy?

Companies are of the opinion that it is necessary to have a statistical measurement tool at European level relating to corporate financing which is as comprehensive as possible, enabling a distinction to be made, in particular, between:

- financing in euros and financing in other currencies (particularly USD);
- financing, depending on the size of the companies (large companies; intermediate-sized companies; small and mid-sized companies).

A statistical tool of this kind could be placed under the auspices of Eurostat or the European Central Bank (ECB).

afep

25 June 2013

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 the drafting of non-sectoral legislation (on the economy, finance, taxation, company law, financial information and markets, competition, intellectual property rights, consumer affairs, social protection, employment legislation, environment and energy, corporate social responsibility, etc.).

In 2013, Afep represents more than 100 of the top private sector companies operating in France. The companies which belong to Afep have 6.7 million employees and a combined turnover of 1,700 billion euros. Their market capitalisation in 2012 amounted to 1,100 billion euros.

As a major force for analysis and proposals, Afep is also a prime forum for contacts between member firms and public authorities, which consult the Association when considering plans for reforms or regulations. 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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