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BELGIQUE

Green Paper on the Long-Term Financing of the European Economy

Dear Mr Merlin,

The Association Française de la Gestion financière (AFG)[1] is grateful for the opportunity to comment on the Commission Services' consultation paper on the long-term financing of the European economy.

[1] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include 426 management companies. They are entrepreneurial or belong to French or foreign banking or insurance groups. AFG members manage 2,900 billion euros in the field of investment management, making in particular the French industry the leader in Europe in terms of financial management location for collective investments (with over 1,500 billion euros managed from France, i.e. 19% of all EU assets managed in the form of investment funds), wherever the funds are domiciled in the EU, and second at worldwide level after the US. In the field of collective investment, our industry includes – beside UCITS – employee savings schemes and products such as regulated hedge funds/funds of hedge funds, private equity funds, real estate funds and socially responsible investment. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA) and of PensionsEurope. AFG is also an active member of the International Investment Funds Association (IIFA).

General comments

1. **AFG is a strong supporter of efficient tools to enhance long-term financing of the European economy. As the European economy will continue suffering from a reduction of financing by banks, alternative financing need to be promoted – in particular through long-term investment funds.**

   From this perspective, AFG strongly supports the Commission's proposal for a Long-Term Investment Fund (p. 9 of the Commission's Green Paper). You will find, attached to AFG's response, a draft proposal for a template of such investment funds.

For long, investment funds and mandates have contributed to such an objective of market financing of regional economies, throughout the world.
Through mandates, individual and institutional investors use the knowledge of asset managers to finance the economy.

The unique features of collective investment schemes make them the tool of reference for financing the long-term development of the European economy, as in particular:

- collective investment schemes are managed by asset management companies which are strictly regulated to ensure they serve their clients and allow them to benefit from special skills at a shared cost

- collective investment schemes, by construction, contribute to diversify the investments in several assets, and therefore to reduce risks.

These two significant advantages of investment funds should be taken on board when comparing them with direct investment in securities, derivatives, real estate or any type of asset: for a large range of investors, investing directly in assets is clearly more risky than asking an asset management company to manage assets on their behalf through a collective investment scheme. And when it comes to investing in specific assets such as SMEs' equity securitisation or infrastructure even sizeable institutional investors gain from using professional third party asset managers.

Thus, investment fund managers are facilitators that allow market access by investors, which otherwise would not dare accessing markets directly or would do it with clearly higher risks (less professional skills, less diversification of investments) than through an investment fund manager, as in particular markets are becoming more and more complex.

In Europe, European legislation contributed to the development of the European economy by building a framework for investment funds, in particular by setting the Undertakings for Collective Investment in Transferable Securities (UCITS).

They play a key role in the long term financing of the European economy by providing States and companies with a vital source of funding. It is true for equity funds and bond funds, obviousy. But also of MMFs which provide with the liquidity needed to let them invest longer resources for longer investment.

However, the UCITS regulation in its current form generates a series of constraints (in particular both in eligible assets and in liquidity rules) which may restrict the use of collective investment schemes in Europe as a way to finance the economy in the long term.

We think that these restrictions should be made more flexible for new types of European funds, which could benefit from a wider range of eligible assets (e.g. real estate assets, infrastructure loans) or a lower requirement of liquidity, in order to be consistent with the need of investing in long term assets or projects.

<u>From this perspective, AFG’s proposal for a long-term investment fund seems an appropriate tool answering the Commission’s goal (see Annex).</u>

Last, the use of Socially Responsible Investment criteria should be encouraged, as it is already largely the case today in France for instance.

2. **The paradoxical reference to tax incentives by the European Commission: we agree that taxation is key for the development and orientation of savings among products and countries. But we therefore don’t understand why in parallel the European Commission is proposing a Financial Transaction Tax (FTT) which might impediment the use of financial markets for the financing of the European economy.** The European common first goal should be to foster savings and especially long term savings, encouraging States to put in place proper incentives and stop discouraging or even raiding reserve funds or employee saving and pension schemes.

The European Commission makes reference to taxation as a factor encouraging long-term saving and financing.

We fully agree with the Commission.

However, the first comment we wish to make is that such a tax approach should avoid any taxation arbitrage within the EU to the benefit of some Member States. If the path of tax incentives has to be followed (and we support it), it should be ensure in a level playing field manner across all Member States. Also, the European Commission should promote tax policies encouraging long term savings and discourage tax policies which are instable, which create disincentives for savings in equities or even raid saving schemes or reserve funds. The European Commission has rightly began to work on European Personal Pension Plans, a move that we strongly encourage and will support, as Efama does with its OCERP concept, by providing concrete proposals. Also, as PensionsEurope, InsuranceEurope and the EBAare rightly repeating, ill-designed regulation such as Solvency 2 or Basel 3 hamper long term investment.

The second comment we wish to make about tax incentives is that it appears as a paradox that on the one hand the Commission raises the point of tax incentives to the benefit of the European economy while in parallel the Commission has launched a proposal for a European Financial Transaction Tax (FTT).

We know that the European FTT is the remit of DG Taxud, while this Green Paper is taken in charge by DG Markt, but as all Commissioners adopt all legislative texts of the Commission in a unanimous manner, the two respective Commissioners should express the same position.

If adopted – it will exactly lead to what the Green Paper is trying to avoid:

- By not being applicable to all Member States, it will generate a strong tax arbitrage to the benefit of the non-taxed marketplaces,

- By taxing the instruments which are the most common tools for long-term investments, such as bonds and equities, it will create an incentive to push investors to very short-term investments such as banking deposits,

- And by taxing the Money Market Funds, it will strongly impediment the optimal management of European issuers' liquidities.

So this ill-designed project should be shelved or profoundly modified.

From another perspective, we don't understand either why in parallel the Commission has expressed its will to prohibit Member States' aides to SMEs, which may take the form of tax benefits, may facilitate the orientation of investments towards SMEs – which are at the heart of the European economy's recovery and creation of jobs.

3. **More generally, Long Term Investment can only develop in a sustainable, predictable and stable legal environment.** Continuous changes in rules, including increasingly at European level, (1) prevent investors from engaging in long term savings, (2) when they do, make more difficult the work of buy-side financial intermediaries such as pension schemes, insurers and asset managers, (3) all the more as companies and infrastructure projects in which they wish to invest are also impacted by this chronic instability.

4. **Several times in the Green Paper, surprisingly enough and without justification, asset managers seem to be repeatedly accused of wrongdoings or at least misbehaviours:**

"*(…) many claim that (…) the behaviour of asset managers create[s] extra costs and misaligned incentives.*" (p. 2)

" *(…) the strategies deployed by asset managers are also cited by many commentators as factors that complicate the intermediation chain, increase the costs of intermediation and create misaligned incentives, such as those arising from the bias towards speculation and short-termism, which are also due to perceived higher risks and delayed returns linked to long-term investment.*" (p. 12)

"*(…) aligning the incentives of asset managers, investors and companies on long-term strategies, mitigating concerns around short-termism, speculation and agency relationships.*" (p. 14)

"*Additional steps could be envisaged, including further assessing the way asset managers' incentives are structured to take better account of long-term considerations and requiring more transparency from asset managers on the fulfilment of their fiduciary duties.*" (p. 14).

We don't understand such a vision of asset managers, as:

- To date, the profession of asset manager is the most regulated in European legislation, as the UCITS and AIFM Directives set a strict framework for managers,

- The UCITS Directive sets in addition a precise framework on the way UCITS funds have to be managed by asset management companies.

At EU level, there is no other legislative framework as prescriptive for any other type of market participant.

In addition, from a public interest and economic perspective, asset managers centrally fuel the savings of investors, both retail and non-retail ones, towards financial markets in order to finance both private and public entities in their needs, to the benefit of the real economy.

The single source quoted in Commission's Green Paper, which appears in the Annex of the Green Paper, seems to be the statements expressed by Mr Kay. If it is the case that the Commission relied on this source only, then we would have doubts on the methodology followed by Commission's services on this point.

Therefore, we ask the Commission to amend such a series of repeated statements which do not seem to reflect the current reality of the management of funds by thousands of asset management companies throughout Europe, and which is more and more used as an example worldwide.

As far as we know, pension funds and insurers trade associations do not share these biased statements and recognise rightly, as we do, that both asset owners and asset managers should continue to work so that their relationship does not favour short-termism.

<u>Detailed comments on Commission's Green Paper</u>

Q1: We agree with the general lines of the analysis of the supply and characteristics of long-term financing as provided by the European Commission. In any case, long-term financing definition should include assets generating cash flows immediately or within a short time-frame. The perimeter of the study should not be limited to greenfield projects.

Q2: Regarding the definition of long-term financing, we support the definition as given by the G20, focusing on maturities of financing in excess of five years, including sources of financing that have no specific maturity (e.g. equities, or long-term maturities – e.g. bonds). It is important as stable financing through equities and bonds, as well as easy short term financing through money market instruments bought by money market funds, allow engaging in long term investment.

Q3: Regarding the future role of banks in the channelling of financing to long-term investments, first of all we think that the evolution of banking regulation is progressively (albeit excessively: the LTFR should be amended) leading banks to a “maturity mismatching” between the term of their resources and the one of their credits. As a consequence, it leads to a reduction of direct long-term financing by banks.

However, in parallel, banks should be still allowed to play an important role in long-term financing through origination and securitisation – as long as these activities are adequately, but not excessively, regulated (e.g. banks, in order to ensure an alignment of interests, should be required to keep a more significant part of originated credits for themselves than in the existing regime). Last, banks will probably reinforce their services on financial markets vis-à-vis issuers, through their role in IPOs or issuances of securities (such as bonds for instance).

Q4: Regarding the role of national and multilateral development banks, we think such banks are fully legitimate in the financing of infrastructures and “*grands projets*”. Public banks may play a useful role in the co-financing of investments with the private sector, in particular for financing innovation (in SMEs for instance) or infrastructures.

However, we think that such banks should concentrate on these projects – which have crucial needs of money – and not to extend their activities to the general financing of companies, which can be better financed through financial markets - through asset management companies in particular. Co-investing can be developed but crowding out must be avoided.

Q6: Regarding the greater role that institutional investors can play in the changing landscape of long-term financing, clearly investment fund managers are key. As already mentioned in our general comments above, investment fund managers are the best way to drive investors towards the most useful investments for the economy, as defined in the investment policy of the relevant investment funds: first, asset management companies are strictly regulated and therefore highly skilled, and second, investment funds diversify the assets they invest in. Therefore, investment funds are a way for investors to reduce risks, both in their choices of investments and in their diversification of investments.

In addition, asset management companies are composed of highly skilled staff regarding the management of long-term assets. In addition, they have progressively developed dedicated competencies in the area of infrastructures to facilitate the diversification of clients’ investments.

Q7: Maturity matching constraints (see Q3 above) generated by Solvency 2 and Basel 3 should be made more flexible. For illiquid long-term assets (more than 10 years for infrastructures), the requirement of Solvency 2 for a valuation every three months does not fit this type of assets and should be made more flexible.

Q8: Regarding pooled investment vehicles, in our view it would be better to facilitate the development of funds of funds for instance: they are less costly, they allow for a high competition among fund managers, and they can be more easily monitored by regulators. And also funds investing directly in long-term assets may also gather several institutional investors. More generally, the advantage of asset management is that is guarantees an alignment of interests with the investor: the cornerstones of asset management are selection of investments and diversification.

Q9: In order to enhance the capacity of banks and institutional investors to channel long-term finance, AFG proposes a model of “long-term investment fund**”. From this perspective, we**

fully support the statement in the Green Paper that the Commission has committed to make proposals on possible forms of Long-Term Investment Funds (LTIFs). Advantages of the LTIF that we propose are given in the Annex of this comment letter. However, we think that such a very helpful instrument will develop only if it becomes eligible to professional investors in particular (although it should be accessible to the retail investors as well), which requires a review of sectorial regulations applicable to professional investors in order to create a favourable regime in the EU on this point. If properly informed, individual investors should also be able to access these funds which could be specifically tailored UCITS and/or ad-hoc funds.

Q10: There are clear cumulative impacts of current and planned prudential reforms on the level and cyclicality of aggregate long-term investment: CRD4 and Solvency 2 are obvious examples. Tax issues such as the European FTT (see below) would also have a huge negative impact on long-term investment.

Q11: The capital market financing of long-term investment in Europe could be facilitated by the launch of a Long-Term Investment Fund (LTIF) (see above as well as the Annex). In addition, securitisation may also be useful – if the regulatory framework is well set, and in particular if banks keep one part of their issuances. Regarding the European project bond market, it may be legitimate as long as the transparency of this market is ensured.

Q12: The equity gap in Europe can be partly filled through the development of LTIFs. The use of Socially Responsible Investment criteria should be encouraged, as it is already largely the case today in France for instance. Also equity investment (directly or through funds) should not be discouraged. MiFID1 was unhelpful in this regard, forcing distributors to issue "warnings" to investors before selling equity products. MiFID2, as it stands today, would make matters much worse, by prohibiting inducements – thus favouring banking accounts or life-insurance.

Q15: Regarding a European specific savings account, we don't see the need for it. The examples which are given in the Green Paper are not necessarily appropriate: for example, the Livret A in France is too restricted in the scope of investments it can invest in and should not be replicated. From this perspective, the wrapper of Long-Term Investment Funds seems more appropriate as it would offer more flexibility and a wider range of possible investments. Auto-enrolment retirement schemes might be an additional solution (such as the PERCO in France). Also personal pension plans should be developed (see the OCERP project by EFAMA).

Q17: In order to set the right incentives at national level for long-term saving, the first action should be to avoid additional taxes on them. For instance, the current proposal for a European Financial Transaction Tax (FTT) might create two terrible issues within the EU: first, a taxation arbitrage between Member States (depending of their adoption or not of the FTT); but also, second, a direct prejudice for long-term saving tools such as equities – while banking saving accounts would not be taxed.

Q20: We agree that the excessive use of fair value accounting principles has led to short-termism in investor behaviour. It is the reason why we think that in duly justified circumstances (e.g. when market values are not meaningful because the market is highly illiquid) an appropriate mark-to-model can be legitimate.

Q21: Regarding the incentives which could be developed to promote better long-term shareholder engagement, we think that AFG's Code of Corporate Governance for Listed Issuers might be helpful, as it has been successfully tested and regularly updated for more than ten years now.

In addition, it seems to us that the Action Plan on European company law and corporate governance planned a coherent frame on those subjects including in particular the idea to encourage employee share ownership throughout Europe.

Encouraging the long term view does not mean to strike a blow in the equality between shareholders, that has to remain a principle as a democratic need ("one share, one vote").

Q22: One cannot separate the activity of asset managers from the companies in which they invest on behalf of their clients. Asset managers keep close track of the strategy and governance of their investments as this information is the basis of both their decisions and their expectations regarding the companies in which they invest.

Since 1998, AFG's Corporate Governance Committee has published a series of *Recommendations on Corporate Governance* (the "Recommendations"). These Recommendations, which concern the general meetings and boards of directors of listed companies, are founded on the following principles:

- An annual general meeting which encourages shareholding democracy
- **The integration of medium and long-term strategic guidelines as well as company environmental and social policy**
- An independent, responsible, efficient and effective board of directors
- Transparent and reasonable remunerations which can be submitted to the general meeting
- "One share, one vote"
- Opposition to "poison pills".

On an ongoing basis, a pre-General Meeting *warning program* draws AFG members' attention to draft resolutions presented at the general meeting of SBF 120 companies which go against these Recommendations and encourages them to actively participate in general meetings. These alerts, which are sent out to AFG members, are also made publicly available via our website (www.afg.asso.fr).

A regularly issued questionnaire asks for members' feedback on the exercise of their voting rights. The information gathered allows for an analysis of the increasing involvement of asset management companies via their participation in general meetings and their active opposition to draft resolutions which run counter to their voting policy (also available on our website).

Therefore, we think that asset managers already behave with a long-term vision of the companies they invest in (they follow AFG's recommendations for voting in AGMs by more than 90%).

Q23: There is no need to revisit the definition of fiduciary duty in the context of long-term financing, as the existing directives on asset managers (such as the MiFID, the UCITS and the AIFM Directives) and on investment funds (such as the UCITS Directive) already set a strict series of rules on them in this respect.

Q26: We fully agree that further steps have to be envisaged in terms of EU regulation or other reforms to facilitate SME access to alternative sources of financing. Today, European small and medium-sized enterprises (SMEs) have difficulties to find stable, lasting sources of financing. Institutional investors and individual savers should be encouraged to make capital investments.

However, currently, the EU provisions published on 18th August 2006 regarding State aids to promote risk capital investments in SMEs impose a limit of €2.5 million per target enterprise, which is clearly an obstacle to the financing of SMEs.

More precisely, these guidelines specify that SMEs may receive, "*tranches of finance, whether wholly or partly financed through State aid, not exceeding EUR 2.5 million per target SME over each period of 12 months.*"

"Local Investment Funds" (such as Fonds d'investissement de proximité – FIP in France) and "Innovation Funds" (such as Fonds communs de placement dans l'innovation – FCPI in France), which are entitled to an income or wealth tax reduction, are impacted by this investment limit set forth by EU legislation. These private equity funds often invest well over €2.5 million, especially if they finance innovative companies.

Thus, we feel that it is absolutely necessary to give more flexibility to the EU rules concerning the financing of SMEs, as SMEs significantly contribute to the economic growth of the EU. Such a higher flexibility of the rules would make it possible to partially compensate for the market's failure to adequately finance SMEs, or would play an important and complementary role to the financing of SMEs by financial markets.

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If you need any further information, please do not hesitate to contact myself at +33 1 44 94 94 29 (p.bollon@afg.asso.fr), our Head of International Affairs Division, Stéphane Janin, at +33 1 44 94 94 04 (s.janin@afg.asso.fr), or our Deputy Head of International Affairs Division, Carine Delfrayssi, at +33 1 44 94 96 58 (c.delfrayssi@afg.asso.fr).

Sincerely Yours,

(Signed)

Pierre Bollon

ANNEX

Creation of a Long Term Investment Fund (LTIF)

Draft proposal

Legal form: General purpose non UCITS investment fund (unless the UCITS Directive is modified)

Target investors: General public

Recommended holding period: 8 years

Eligible assets : equities and assimilated securities, listed or not, all kinds of debt instruments, listed or not (including shares of securitization funds, loans, mutualized issues, financing of infrastructures…), real estate, long term deposit accounts and cash

Eligibility ratio: only one: at least 15% of the portfolio invested in equities

Ratios relating to the division of risks:

- General rule : no more than 5% of the portfolio on a single issuer
- Exceptions:
  - no limitation for a single sovereign security
  - Up to 30% for a single debt issuer (except sovereign)
  - UCITS Directive “5,10,40”rule for shares

Financial management: by an asset management company complying with a professional code of good practice. Both UCITS Management Companies and AIF Management Companies should be eligible for managing LTIFs (but complying in addition with any specific requirement related to the management of LTIFs, if needed).

Depositary: required

Valuation of the assets and of the shares/units: by an expert and approved by an auditor

Subscription/redemption: at NAV at least on a semiannual basis, taking into account the negotiation spread. Possibility of notices and “gates”.

Negotiation spread: cost of liquidity measured by the difference between the value of the assets and their mark to market value at the date of subscription/redemption. The negotiation spread is borne by/to the benefit of investors.

Desirable tax treatment: tax incentives will have to be considered to encourage long term investment funds.

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