Association Française des Trésoriers d'Entreprise

May 11th 2015

AFTE response to the European Commission consultation on the Green Paper on creating a Capital Markets Union

The AFTE appreciates the opportunity to comment broadly on this Green Paper consultation and favours all initiatives that aim to support the European economy.

The AFTE is in favour of an appropriate regulation package to ensure financial stability. However, we advocate effective implementation of a well-balanced regulation to avoid negative consequences and constraints on non-financials companies' ability to fund themselves, manage their various risks and handle their liquidity requirements. In this respect, we note that the recent regulatory focus on reducing counterparty risk has resulted in increasing liquidity issues for number of market players.

Funding of the real economy is a key factor. In the past years, European companies have diversified their funding sources. The AFTE welcomes the fact that Europe seeks to supplement bank funding sources with non-bank funding sources. The AFTE recognizes that European companies should not fully depend on the health of the banking sector. Nevertheless, we strongly encourage regulators to give banks the ability to exercise their core business (i.e. financing "real" economy) and we also believe that banking credit to corporates should not be sidelined by the development of stronger capital market funding for such corporates : in this respect, we note that liquidity ratios under CRD IV and CRR (both LCR and NSFR) have created difficulties for ensuring credit provision to corporate entities. The AFTE believes that efficient bank supervision will be more relevant and effective to ensure the limitation of systemic risk, rather than an excessive regulatory framework, i.e. the "Basel 3"/CRD IV regulation has made bank financing more restrictive and costly both in terms of allocated capital and complying with the liquidity buffer. Overall European companies should have the choice of and access to different and varied funding sources : capital markets, on one side, and bank funding on the other side.

With CRD IV, banks are required to increase their capital and liquidity levels : they are inclined to do this by deleveraging, rather than raising fresh capital. In general, banks' behaviour in terms of lending seems to be way more driven by the necessity to comply with different regulatory ratios and requirements rather than by addressing real economic needs. We kindly remind the Commission that an over regulated market can result in a growing move to shadow banking which can in turn generate increasing risks for the financial system.

As a preliminary comment, we would therefore encourage relevant decision-makers to review whether or not some aspects of the capital and liquidity requirements in place are excessive in relation to risks and whether banks' regulatory capital and liquidity buffers effectively mitigate such risks. We believe that the EU banking system must be able to continue to play its role in the economy of maturity transformation and funding of companies – we see a fundamental problem in the system if banks are only able to perform these tasks on a significantly reduced scale.

1) Beyond the five priority areas identified for short term action, what other areas should be prioritised?

We generally support action in the priority areas identified by the Green Paper and would like to make the following comments:

- We generally support the encouragement for **securitisation** as it is a source of funding, creates liquidity, and widens and deepens financial markets. However, regulatory oversight is particularly important in view of the recent crisis specifically with respect to the quality of assets or receivables which are subject to securitisation and subsequent investor information.

  It is of great importance that companies retain the ability to negotiate non-assignment clauses in respect of their transactions with banks. Managing the exposure to financial institutions is a key part of good corporate treasury practice; there is a threat of concentration of bank exposures in case of assignment from one bank to another. The ability to negotiate non-assignment clauses is also important because companies should have the ability to choose their investors. Furthermore, for fast-growing firms or for weaker credits, the relationship with banks can be formalised in "incomplete contracts" – both sides expecting that in case of temporary problems or new opportunities, the lender will show some understanding and (prudent) flexibility. Assignment to an unsympathetic bank or to a securitisation scheme with no ability to review, consider, and adjust can cause major problems, even failure of the firm.

- We also very much welcome the review of the **Prospectus Directive;** we would point out that in our experience prospectuses were more easily readable before the review that took place in 2010. Complex and costly prospectuses have the negative impact of both restricting the access of certain companies to equity finance (as the cost of producing a prospectus can be too high compared to the other advantages). This cost factor (including the internal costs of management time, etc.) is particularly relevant for SMEs and smaller mid-sized firms. More complexity decreases prospectuses' relevance and meaningfulness to investors, which goes against the Directive's initial purpose. Broadly speaking we would encourage the following enhancements to the current Directive:

  - Increasing the thresholds above which a prospectus needs to be produced for a public offer – the main thresholds being the fundraising threshold and the number of persons. Furthermore, the limit on the number of persons should be clarified so that it is clear that it applies per Member State and is not an aggregate limit across all Member States.
  - The scope of the Directive should not be enlarged beyond transferable securities

In the same area, the deletion of "exemption 2(k)" for commodity dealers under MiFID and the contemplated introduction of a cumulative capital and trading test – which we understand will be set at extremely low thresholds – to simply qualify as "ancillary activity" under the Directive, and consequently be authorised to enter into a commodity-related derivative without requiring a license to operate as an investment service provider (which will require regulatory capital and other prudential requirements), does not seem appropriate nor relevant for corporate groups whose economic activity results in the conduct of commodity-related transactions without any threat to financial stability. Consequently, we strongly encourage the Commission to adopt a more flexible and reasonable approach when setting out the parameters which will define the capital and trading tests.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

2) What further steps around the availability and standardisation of SME credit information could support a deeper market in SME and start-up finance and a wider investor base?

The AFTE is in favour of improving the quality and availability of SME credit information, however we consider that an imposed harmonisation of SME credit information as envisaged by the Commission would not necessarily achieve the desired goals.

The objective of having companies harmonise, publish and communicate information is a laudable one but we would encourage the Commission to keep the following aspects in mind:

- Financial disclosure: we believe that systematic disclosure of statutory accounts of all companies benefiting from 'limited liability status' (and its equivalent under the jurisdictions of all Member States) should be mandatory. Setting up a centralized public registry in this respect, which would be open to the public against a fee designed to remunerate the administrative costs of maintaining such a service (similar in nature to the UK Companies' Registry), should be encouraged at an EU level with a view to increase the level of information available improve information transparency. Such transparency could not only ease the provision of liquidity under funding schemes and improve credit scoring / corporate rating procedures, but also become a significant tool to improve investor confidence towards new sources of investment within a unified EU capital market.
- Accounting standards: harmonisation of national accounting standard is a key point. The AFTE does not see an added value in creating a new and simplified accounting standard for SMEs; the adoption of IFRS should be a priority; IFRS for SMEs could be a better alternative, bearing in mind however that IFR standards cannot realistically be applied in a full version by small or mid-cap companies (a lighter version of IFRS could therefore be explored).
    - If a European working group on accounting standards is launched, the AFTE is available and willing to contribute.
- Credit analysis: the AFTE notes that credit rating agencies have a relatively low appetite to rate SMEs. However we believe that credit information are important in a well-functioning capital market. . "Credit scoring" based on historical financial statements can be helpful for stable and low-growth firms, but, importantly in the context of encouraging economic growth, for growing firms in changing industries and those in new fields in high-tech or bio-tech, historical figures are a very poor guide to the future.
    - Investors should assess their risk exposure, whether performing their own analysis or through credit rating agencies: the first option can lead to a fragmentation of analysis and the loss of a harmonised rating scale. However, we believe that, for private placements, the relationship between investors and companies has a key role and would therefore encourage investors to perform their own assessment.
    - The AFTE is not in favour of a mandatory rating for SMEs and encourages the EC to benchmark the various practices in place in Europe. The AFTE is available and ready to join a working group on the subject.

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

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

4) Is any action by the EU needed to support the development of private placement markets other than supporting market-led efforts to agree common standards?

In our view, the conditions and the framework for the development of a pan-European private placement market are identified and able to be put already in place at the Member State level. We do not see any major legal or operational obstacles and would therefore not favour any legislative action from the Commission in this respect with one small exception.

The main challenge we see at this point is whether investors will have enough appetite to invest in this type of market. From this point of view, it would be beneficial for the development of a pan-European private placement market if restrictions to invest in this market were lifted – both in terms of existing restrictions to cross-border investment (we understand that for instance certain regional banks in Europe are not allowed to invest in foreign assets) and in terms of the capital charges imposed especially on institutional investors (Solvency II).

We note the Euro PP Working Group has drafted and made publicly available standard template documentation for both private placement formats (loans and bonds). Such documents are simple, efficient, adaptable to further customisation (including making them governed by different systems of law) and very balanced between the interests of borrowers/issuers and investors, contrary to the LMA equivalents which are one-sided in favour of investors and extremely heavy to manage. We consequently encourage the Commission to endorse such EuroPP Working Group template documents and ensure their promotion.

The AFTE would like to highlight that standard and simple documentation can play a crucial role in facilitating access to private placements. Therefore we would encourage the Commission and all other relevant institutions to endorse such template documents and recognize this in the course of their future actions. The Commission could for instance offer the translation of the documentation in all official EU languages and support the Euro PP Working Group initiative.

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

The AFTE is convinced that a regulated short-term debt market, i.e. "commercial paper" (on the basis for instance of the French "*billets de trésorerie*") is a well-functioning one and can source funds at interesting rates while ensuring a decent standard for investors, however not so many companies are funded through this market. We suggest that the EC should promote a euro commercial paper market on the grounds of being regulated, transparent and efficient. The EC should also communicate on the development of such ECP market to investors from third-party countries.

As credit rating is mandatory for issuing short-term debt paper, the AFTE is in favour of implementing a harmonized rating methodology.

The AFTE also would suggest to regulators that they request credit rating agencies to review their short-term methodology, which we have observed to be derived merely from the long term rating rather than a stand-alone assessment for short maturities.
On another topic, the AFTE notes that the Commission could encourage the removal of any national legislative or regulatory barriers to corporate lending.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

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

We are concerned at suggestions on the part of the asset management community that it would be beneficial to impose standardised maturities and coupon dates on corporate bond issuance. Whilst this may be attractive for investors, such an approach would not reflect issuers' underlying funding requirements, which are not susceptible to such regimentation. Standardisation of the mechanics of issue and some of the "boiler plate" in documentation is already substantial and increments in this can be left to capital markets participants to identify and agree as good practice over time.

We would welcome any initiative that encourages commercial paper and bond brokers to further develop electronic trading platforms, in particular multi broker trading platforms, such as those seen on the Foreign Exchange market. This would provide greater liquidity in the commercial paper and bond market and reduce transaction costs. It goes without saying that standardisation of conditions – covenants, etc. – would be wholly inappropriate as contingencies vary greatly from issuer to issuer and from issue to issue.

7) Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environment, Social and Governance) investment, including green bonds, other than supporting the development of guidelines by the market?
8) Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

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

The AFTE is not against any innovative approach; however, we believe that the development of crowdfunding and peer to peer lending, if they may not threaten the financial stability, can generate risks for investors who are not professionals and may be less experienced in assessing such risks: if credit risk is not well assessed, individuals investing in peer to peer lending can occurs losses that can damage their confidence to concur to finance the real economy. We therefore acknowledge the current development of crowdfunding and peer to peer platforms and encourage competent authorities to remain vigilant.

We think these new sources of funding have emerged because regulations have reduced the ability of banks to fund the real economy. We believe that EU should not intervene with additional regulation but at least should monitor these activities which we consider to be an indirect form of shadow banking.

A priori such risks are at present highly unlikely to be on a scale threatening financial stability but there can be retail investor information and protection issues and these are mostly dealt with at Member State levels.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

10) What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?
11) What steps could be taken to reduce the costs to fund managers of setting up and marketing funds across the EU? What barriers are there to funds benefiting from economies of scale?
12) Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets? If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?
13) Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?
14) Would changes to the EuVECA and EuSEF Regulations make it easier for larger EU fund managers to run these types of funds? What other changes if any should be made to increase the number of these types of fund?

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

We view the private equity and venture capital sectors as best driven by the market. Direct intervention is therefore not seen as a priority.

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

As explained in our introductory comments, we encourage relevant decision-makers to review whether or not some aspects of the capital and liquidity requirements in place are excessive in relation to risks and whether banks' regulatory capital and liquidity buffers effectively mitigate such risks. We believe that the EU banking system must be able to continue to play its role in the economy of maturity transformation and funding of companies as well as enabling them to manage their risks – we see a fundamental problem in the system if banks are only able to perform these tasks on a significantly reduced scale.

17) How can cross border retail participation in UCITS be increased?
18) How can the ESAs further contribute to ensuring consumer and investor protection?

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

We believe that measures should be taken in order to direct more private savings to invest in companies. Different actions could be considered and the general aim of any reform should be to give private investors the choice between investing in companies directly, via collective funds or through private savings plans:

- In general, using the tax system to encourage investment in equities and other corporate assets to help protect individuals' long-term savings
- In the area of corporate governance and corporate law where certain requirements for issuers should be reviewed and eased, for instance the requirements regarding prospectuses (see our response to question 1)
- Seeking to achieve harmonisation (preferably abolition) of withholding tax

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

- Seeking to remove any restrictions on the inclusion of corporate bonds, equity issued by a company located in another Member State and other relevant products in private saving plans which benefit from favourable tax treatment

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

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

We strongly recommand the EC to harmonize taxation amongst European countries, both for corporate taxes and for citizens' income taxes.

We believe the single most important action is to abandon the Financial Transaction Tax proposal as it represents a major potential obstacle to attract investment in the EU. Since the beginning of the FTT discussion the AFTE has expressed its concerns on the tax, which would essentially be a tax on the real economy, on pensions and on savings. We strongly believe that the FTT will not deliver its objectives of making the banking sector contribute to the cost of the crisis and creating disincentives for certain financial activities that may be viewed as not bringing an added value to the overall economy. It will on the contrary add further difficulties to the struggling European economy. The FTT will cause serious damage to companies, pension funds and individuals as users of financial services, by directly and indirectly burdening them with additional costs. The FTT will not in the end fall solely on the financial sector and force it to make a fair contribution to the costs of the financial crisis but will do just the opposite. It will fall on companies in the real economy and compound the negative effects of the financial crisis that businesses have already experienced. In the current economic context this outcome is the opposite of what EU policy should be seeking to achieve. Furthermore, as other major jurisdictions have not and are not planning to implement an FTT, the tax would put EU companies in a competitive disadvantage and would discourage investment, compounding the problem.

The FTT is particularly in contradiction with the aim of creating a well-functioning Capital Market Union in that it would increase the cost of funding and tighten credit conditions for EU companies. Issuers of corporate debt would have to offer higher returns to investors due to FTT eroding investors' returns, thereby raising the overall cost of capital. Liquidity in secondary markets would also be likely to be reduced, putting further upward pressure on the cost of capital. Managing the risks associated with funding (and with basic business transactions) would be more costly and difficult given the impact on derivatives used for these purposes.

We believe that the Commission and the 11 Member States participating in the enhanced cooperation procedure should withdraw the FTT proposal from the table immediately and concentrate on other areas of taxation that would be less harmful to the economy and could bring more societal benefits. Whilst banks should be sanctioned for any demonstrated misconduct or market manipulation, it is not beneficial or forward-looking for the European economy to impose such a tax with the misguided objective to make banks contribute to the costs of the crisis. We understand the political sensitivity of the matter due to the perception that the public opinion would "demand" such a measures imposed on banks but we firmly believe that any public policy should first and foremost consider the broad economic and societal impact ahead of considerations of political popularity.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

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

Negotiation of favourable withholding tax and double taxation treaties in order to encourage EU firms' access to third countries.

23) Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

We would favour moves to increase issuers' ability to identify their bond holders, thereby facilitating the process of launching a tender on a company's own bonds (so as to facilitate its debt profile management).

Due to the fact that bonds are held through various central custodians, there are currently multiple circuits for issuing and settling bonds. The situation is different in the US where all bonds are held through a single custodian (DTCC). Therefore it might be beneficial to have one single central custodian for all bond issuances in the EU with the aim to have lower transaction costs, better liquidity and higher market efficiency.

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

25) Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a capital markets union?

We recognise that the ESAs – or any future authority to be created in the area of capital markets – will have an important role and impact on the manner in which different measures relating to the CMU will be implemented. The level 2 measures are more than often of critical importance from the practitioners' point of view, and it is important to ensure their quality.

As a general remark, we would like to point out that in order to take on any new responsibilities and in order to carry out any new tasks, the funding and resourcing of the ESAs should be considerably strengthened.

In the recent years our members have been impacted by numerous measures drafted by the ESAs (especially ESMA) and we have been actively engaging as a stakeholder in particular through public consultations. We have generally felt disappointment in some aspects of the functioning of ESMA: we have found little interest or understanding of the non-financial sector and its specificities as an end-user of the financial system. However, the ESAs regulate on issues that deal with and impact actors both in the financial and non-financial sectors, and therefore we would expect the authorities to have an understanding of both and to consider both as serious stakeholders.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

We believe that the following aspects would bring substantial benefit to end-users and are necessary in order to achieve a meaningful contribution from the ESAs:

1. The ESAs should take into account also the public policy aspects of financial regulation in their work, and not only purely technical aspects. We do understand and appreciate that it is not in the mandate of the ESAs to develop public policy, but we consider it very important that the ESAs have a respect for the underlying policy objectives or regulation, and more importantly that the ESAs adhere to the spirit and the letter of the level 1 texts.

2. The ESAs should be serious about having adequate representation of all stakeholder groups impacted by regulation in their stakeholder groups. Currently there is a complete absence of transparency and accountability on ESMA's part and appointments appear to be driven by what can best be described as political and academic correctness, as opposed to seeking to identify the best and most relevant people in terms of skills, experience and real rather than nominal stakeholder representation. We are particularly disappointed by ESMA's repeated failure to appoint corporate treasury representatives to the stakeholder groups and have filed an official complaint to the EU Ombudsman on the latest appointment of ESMA's main stakeholder group, the Securities and Markets Stakeholder Group (SMSG). In our view the representation of the ESMA SMSG is unbalanced as it does not include any recognised representatives from the users of financial markets within non-financial companies. These companies are a key segment of end-users of financial services; they have been and will continue to be heavily impacted by financial services legislation. Indeed a large part of the social role of the financial services sector is support of real economy firms and that must not be ignored.

26) Taking into account past experience, are there targeted changes to securities ownership rules that could contribute to more integrated capital markets within the EU?

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

Clear rules should be in place concerning the ownership of collateral in case of re-hypothecation.

Furthermore, market participants should have the option to agree on a contract-by-contract basis either to prohibit or allow:

i) Broad/flexible types of collateral including in the form of a pledge rather than a transfer of title, as it would help to prevent price distortions of high quality collateral in the market due to artificial demand to fulfill regulatory requirements.

ii) Limited re-hypothecation of initial margin, to balance the risks of allowing re-hypothecation against the extensive costs to non-financial and non-bank financial counterparties in purchasing collateral and safely storing counterparty collateral, which ties up working capital that otherwise could be put towards growth in the wider economy.

iii) Netting between the parties.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

Segregation of collaterals into silos by currency should not be required as it is expected to lead to operational complexities which could further expose non-financial and non-bank financial counterparties to additional currency exposure.

28) What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?
29) What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

30) What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

As noted above in response to question 19, we would support moves to harmonise withholding tax regimes.

On a preliminary note, the AFTE would like to point out that corporate entities should remain entirely free to choose their preferred mode of financing. In other terms, tax rules should not become the driver behind selecting one financing mode to another (debt vs. equity). In this respect, the implementation of the French tax rule commonly referred to as the "*rabot*" (25% of non deductible interest, whatever the circumstances) introduces a significant distorsion in the choices of financing schemes set up by corporates for the purposes of their funding requirements.

With regard to taxation, we would like to make the following suggestions:

- The tax treatment of the difference sources of financing should be as neutral as possible to avoid distortion of investment decisions. Equity financed investment decisions remain significantly hampered in many EU countries by a corporate income tax system that presents a strong bias towards debt over equity financed investments. The efforts to remove distortions between the fiscal treatment of debt and equity should however focus on improving the fiscal treatment of equity rather than impairing the fiscal treatment of interest costs.

- Any form of fiscal discrimination between residents and non-residents (or national and non-national) should be abolished. In order to fully reap the benefits of the Capital Markets Union and to generally attract investment in EU companies, Member States must accept more flexibility in the taxation of capital. As a matter of examples, the French tax of 3% on dividends applies to dividends distributed to shareholders which reside in another Member State, whereas dividends distributed to a French company can be exempted fully under the French tax integration rules ("*intégration fiscale*"). This type of tax on dividends – and more generally any tax on capital – results in increasing the cost of capital, therefore reducing its availability. Any such taxes penalizing capital is consequently counter-productive, in a context where available capital is sought for investing into corporate entities at the EU level.

- The EU should move towards the harmonization of tax regimes, for instance dividend withholding tax. We would favour an exemption from withholding tax in all Member States.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

- Additionally, Member States should develop tax regimes that are supportive of long-term investment aims in Europe by being predictable and globally competitive. This will require Member States to have a clear consensus on their policy objectives as well as consultation with tax collectors and tax payers on the efficient means of achieving these policy objectives.

As a matter of illustration, tax rules applicable to retail investments (equity shares, bonds and fund/UCITS shares) are very different from one country to another, are complex and unstable, and generally tend to favor investments (equity and fund/UCITS shares) into local companies, being detrimental to foreign companies including those within the EU. Such rules represent a material impediment to drawing retail savings toward European companies. The AFTE advocates setting up a unified investment plan across the EU, which would allow being granted a single tax treatment whatever your country of residence. Banning any form of withholding tax on dividends, upon justification of fiscal residence within the EU by the beneficiary, would be a significant step in that direction.

In the context of building a capital markets union, particularly if Member States intend to release a significant wave of investments into companies between Member States, it will be necessary for them to accept more flexibility on capital taxation in their own home State. European support to the creation of an individual savings instrument similar, in its nature, to a French "PEA" (« *plan d'épargne actions* », i.e. equity shares' savings plan) or to the British ISA (Individual Savings Action) to provide full exemption on received dividends or interests and on added value, would be a major positive step forward with a view to release domestic liquidity into investments at an EU level.

Last, several options exist across existing tax systems in order to facilitate funding of "start up" companies and innovative or young companies. Efficient illustrations of this kind include the possibility for the company, in particular when in deficit, to sell for cash their tax credits resulting from research and development (R&D) efforts to the tax authorities (or to a third party, subject to certain restrictions to avoid abusive behavior). Allowing the same scheme for tax losses, in the same type of circumstances, would also be an important way for tax authorities to directly facilitate the financing of innovative companies. Such mechanisms would mean relying on a cost as tax basis, on a temporary duration and with the likelyhood that it will generate income in the middle-term, at which point innovative companies have grown and represent future taxpayers.

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

Seeking to nurture whenever possible developments relying on new technologies and business models, with intervention only when these innovations put non-professional users at risk or threaten financial stability.

32) Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

As mentioned in the introduction, we firmly believe that the Capital Markets Union should also consider reviewing some of the recent years' legislative measures due to their negative impact on the economy and what we consider a fundamental failure to understand and take account of financial regulation's impact beyond the financial system. Below we would like to give an overview of these impacts and suggest changes going forward.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

How has the real economy been impacted by financial regulation in the recent years?

Non-financial companies depend on the financial system to provide essential services for conducting their business. These can vary from deposit-taking, payment services, working capital finance, risk management services, provision of debt finance, assistance with access to other markets, investing excess cash and advisory services across the whole range of financial management. Therefore the non-financial sector has been both directly and indirectly impacted by the regulatory changes that have and are still taking place in financial services:

- **Risk management:** non-financial companies use OTC derivatives as they are best suited to hedge companies' financial risks. As opposed to centrally cleared and exchange-traded derivatives, non-cleared OTC derivatives can be tailor-made to cover most efficiently the specific financial risk a company is facing, and they do not expose non-financial companies to the unmanageable liquidity risk that margin calls would represent. We wish to highlight that this use of OTC derivatives is made for business and commercial purposes and not for speculation, and it is economically beneficial as it helps to reduce volatility in the real economy.

  The recent years' regulatory agenda has sought to push as much trading as possible to central clearing and on exchanges, which for a large part of the market (intra-financial services) is surely justified. The current regulatory framework (EMIR) partly exempts non-financial companies' hedging transactions from such obligations, but it imposes other significant obligations that unduly burden non-financial companies for little or no benefit to the supervisors. This is especially so as non-financial companies collectively represent a tiny proportion of the OTC markets and inter-connectedness among non-financials is much less than among financial firms while granularity is higher.

  We also stress that continued pressure on the use OTC derivatives (e.g. bank structural reform, CRD IV CVA risk capital calculation) is a source of uncertainty and detrimental to the pricing and conditions that non-financial companies will have on their transactions and has seen reductions in the number of banks happy to supply these services in the required volumes.

  We believe that public authorities should consider how different financial reforms will impact the overall market for and prices and availability of derivatives and therefore also non-financial companies' hedging actions. If companies as a whole were to be pushed to reduce their hedging volumes or stop hedging altogether, their operational risks would materially increase. This outcome would inevitably threaten financial stability, employment and growth as well as directly increasing risk for their lending banks.

- **Cumulative impact of regulation:** The accumulation of all the post-crisis financial regulation since 2008 brings with it – in implementation – a real risk of inconsistent outcomes and unintended consequences. It is important therefore to look critically at the case for each incremental piece of new regulation and its real impact given all the pre-existing regulation.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

- **Global convergence:** the impact and cost of regulatory change is amplified for companies operating internationally faced with inconsistent rules globally and the obligation to comply with different legal frameworks. Coherence and consistency of regulation at G20 level should be one of the main objectives of the legislator. Regulators at the global level should of course also have in mind the effects of regulation on real economy firms.

How should the existing legislation or legislative measures in the pipeline be amended?

Regulation must be well adapted to support the growth agenda; we believe the following changes are needed in order to achieve this:

I. EMIR

The burden on non-financial companies that use OTC derivatives to hedge their underlying commercial and financial risks should be considerably reduced and simplified. Non-financial companies have invested and continue to invest considerable funds in the implementation and on-going compliance with EMIR[1], particularly in the area of reporting. However, we very strongly feel that this investment does not contribute to greater financial stability – as non-financial counterparties do not have the same systemic relevance as financial counterparties - but it drains funds from more productive investment.

The balance sheets of non-Financial corporates above the clearing threshold (NFC+) are likely to be significantly hit through the tying up of liquid assets with the future EMIR margining requirements. We believe that EMIR should require the central clearing of only the asset class in which an NFC is above the clearing threshold, and should not apply to all asset classes as is currently required. Imposing variation margin on hedging transactions below the clearing thresholds will expose NFC+s to daily volatility up to the settlement date of the underlying commercial transaction and will entail higher levels of working capital. This will tie up liquidity which could otherwise be invested in the real economy.

We therefore consider that two main changes are needed to the current EMIR regime:

- One-sided reporting: we see absolutely no added value in reporting the same transaction twice, both by the financial and the non-financial counterparty. The EU should adopt one-sided reporting as this would not compromise the supervisors' ability to monitor systemic risk but would greatly ease the burden on companies.

- Exempting non-financials' intra-group transactions from the reporting requirement. Non-financial companies centralise risk management for the purposes of efficiency and cost saving. External derivative transactions (usually of net but sometimes of gross exposures) are often undertaken by a central unit and these are then mirrored appropriately as intra-group transactions with the part of the group where the underlying business risk has arisen. While it significantly increases the reporting burden on companies, reporting the intra-group transactions does not bring any additional value to the supervisor, as the related external trades have already indirectly been reported by

[1] We could put a link to the survey results here if we have a report by then

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

the counterparties (as well as, under current requirements, by the companies as an external transaction – see previous bullet point)..

We believe that these improvements to EMIR would also be helpful to the supervisor as they would decrease the number of reported transactions that bear no systemic significance, and would therefore allow the supervisor to better monitor real systemic risk concentrations within the financial system.

We would encourage the Commission to consider an additional item in the short-term actions: **FX transactions undertaken for commercial purposes** by non-financial companies should **not be understood as financial instruments** under MiFID. This issue has been raised as part of the difficulties linked to the reporting obligation under EMIR but no solution has been proposed so far. There are different interpretations in Member States as to the definition of an FX forward and whether an FX transaction carried out for commercial purposes is a financial instrument. This unharmonised approach at EU level is not helpful for companies and we would encourage the Commission to take the necessary steps to clarify this point as soon as possible.

For non-financial companies the need for managing foreign exchange exposures arises from their commercial transactions and the conduct of daily business, including purchases from suppliers or vendors, sales to customers in other countries and currencies and changes in commodity prices. FX transactions are commonly used by non-financial companies of all sizes for purposes that are linked to the underlying business and not for investment or speculation. Such transactions promote rather than threaten financial stability; obliging non-financial companies to report their transactions does not in our view help to reduce systemic risk but instead puts a significant compliance burden on non-financial actors. A clarification that these transactions, when undertaken for commercial purposes, are not classified as financial instruments under MiFID would help to reduce the regulatory burden on non-financial companies and allow them to focus on the core aim of promoting jobs and growth across Europe.

II. MIFID

The deletion of “exemption 2(k)” for commodity dealers under MiFID and the contemplated introduction of a cumulative capital and trading test – which we understand will be set at extremely low thresholds – to simply qualify as “ancillary activity” under the Directive, and consequently be authorised to enter into a commodity-related derivative without requiring a license to operate as an investment service provider (which will require regulatory capital and other prudential requirements), does not seem appropriate nor relevant for corporate groups whose economic activity results in the conduct of commodity-related transactions without any threat to financial stability. Consequently, we strongly encourage the Commission to adopt a more flexible and reasonable approach when setting out the parameters which will define the capital and trading tests.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

III. CRD IV

a) Capital and liquidity requirements

Whilst the AFTE of course recognises the need to ensure correct levels of bank capital, we would encourage the decision-makers to review whether or not some aspects of the capital and liquidity requirements in place are excessive in relation to risks to bank capital. We believe that the EU banking system must be able to continue to play its role in the economy of maturity transformation and funding and risk management of companies – we see a fundamental problem in the system if banks are only able to perform these tasks on a severely reduced scale.

b) CVAs

The economic importance of non-financial companies hedging their risks by using OTC derivatives was recognised in CRD IV, in exempting non-financial counterparties from the Credit Valuation Adjustment (CVA) risk capital charge calculation. This exemption is instrumental in giving European companies access to more reasonably priced risk management products, but it has been challenged both at international level (the Basel Committee) and at EU level (by the EBA in its technical advice to the Commission published on 26 February). We found it extremely frustrating that the EBA as a supervisory authority seeks to modify the essence of a policy principle that has been agreed by the legislators in the level 1 text. As we underline in our response to question 25, the ESAs should understand and respect the policy goals and principles of the level 1 text.

We advocate for the maintenance of the EU exemption and would encourage the Basel Committee to take the views of and impact on the real economy end-users into account in formulating changes to CVA as part of their work in the Fundamental Review of the Trading Book.

IV. Bank structural separation

We are not convinced of the need to introduce a fundamental separation of banking activities as proposed by the Commission. Given the plethora of ways in which a bank can work with a company it is inherently difficult to argue, from the perspective of the real economy, that there would be major benefits from legislatively imposed separation of certain activities within a bank. On the contrary there are evident benefits from institutional size and diversification, provided that the management processes are prudent, based on sound controls, with good governance and effectively monitored by stakeholders.

If however a separation is put in place, the Regulation needs to be framed around a much narrower trading entity and a broader deposit entity, allowing the latter to offer the services that non-financial companies require from their banks. Many of the activities that the Commission is proposing to separate to a trading unit are necessary and have value to the wider economy; they should not be under-valued by being assumed to be inherently risky and undesirable, in an overzealous attempt to reduce bank size. The following two aspects should specifically be addressed:

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

- Capital market activity such as market-making should not be subject to separation as it benefits the real economy in that it supports the issuance of equity and bonds by non-financial companies with vital immediate liquidity. Its proposed separation to a trading unit would therefore completely go against the aims of the Capital Market Union, as such a separation could substantially limit the ability of financial institutions to underwrite and make markets for corporate bond issuance.

- The prohibition on the core institution to offer non-centrally cleared OTC derivatives to their non-financial clients should be deleted in order to preserve the ability of companies to manage their financial and market risk exposures.

V. Money Market Fund Regulation

MMFs are an important cash management tool and are buyers of short-term commercial paper. From an investor perspective, MMFs offer a highly liquid and secure alternative to bank deposits and a way to diversify cash deposits. For non-financial companies it is important that the continued existence of both Constant Net Asset Value (CNAV) and Variable Net Asset Value (VNAV) funds is ensured. This is all the more important in a context where bank deposits are at the same time becoming more risky from corporates' perspective (possibility of a bail-in) and corporate short-term deposits may be undesirable from the banks' point of view (Basel III / CRD IV). Providing companies with the necessary cash management tools is increasingly important in such a context.

Furthermore, any implementation of a ban on ratings of MMFs would effectively destroy the market for all those (other than banks) who rely on the provision of sound ratings to guide investment. The combination of the threats to MMFs contained within the proposed Regulation would, if implemented, perversely lead to an increase in systemic financial risk, as a result of a forced concentration of liquidity in a small number of well rated 'national champion' banks.

VI. Benchmark Regulation

The Commission's proposal for regulating financial benchmarks is an understandable initiative given the many cases of benchmark manipulation over the recent years. However, we believe that the legislator should be very careful not to over-regulate in this area. Firstly, if the scope of the Regulation is too large or inappropriately calibrated and/or if the administrative and compliance burden are too great, certain important benchmarks might cease to be published. Alternatively, contributors might choose to retire from panels (where membership is not made mandatory), in fact making benchmarks more volatile and unrepresentative of the underlying market and perhaps eventually making publication of the benchmark impossible.

Secondly, the Regulation should not lead to the unavailability of third country benchmarks. The Commission proposal would have the effect of seriously restricting the availability of non-EU benchmarks, which would unduly restrict access to appropriate financial instruments. Furthermore, the legal, contractual and practical consequences of discontinuation of important benchmarks should be taken seriously and necessary provisions should be foreseen (e.g. "grandfathering" clauses) in the legislation.

The legislators should ensure that benchmark administrators have proportionate, sound governance processes in place and that appropriate sanctions exists in case of market abuse and manipulation, while keeping in mind that the legislation should not lead to a significant reduction in the availability of benchmarks in the market.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

VII. Credit Rating Agencies Regulation

Credit ratings are important in a well-functioning capital market as we believe that credit ratings are an important mechanism for providing good quality analysis to the markets.

Non-financial companies make use of credit ratings in a variety of ways, for instance to support funding from financial markets and to assess the risk of exposures with financial counterparties

Having in mind the possible review in 2016 – which in our view is not necessary at this point due to the thorough review of the legal framework in the recent years - we would like to highlight the following aspects:

- Reducing over-reliance on credit ratings : whilst we understand the objective, we would like to stress that this objective must not lead to banning the use of credit ratings, at least where such a ban could have serious consequences on end-users. The reduction of over-reliance to credit ratings should come from sustained market encouragement not to rely solely on credit ratings.

- Mandatory rotation of CRAs: the idea of a mandatory rotation on corporate ratings should be abandoned as this would seriously impact the efficiency of funding markets for the real economy. Corporates should be allowed to use an agency with suitable expertise and knowledge of the corporate, and a recognised (international) reputation.

- Issuer pays / Investor pays model : from the perspective of corporate issuers the 'issuer pays' business model has proven to be the most practical and suitable for both issuers and investors. Any eventual move to the 'investor pays' model is likely to result in reduced coverage of companies – especially of sub-investment grade and of mid-sized and smaller companies. This would go completely against the aim to create a Capital Markets Union and would be counterproductive.

How the decision-makers can better recognise end-user impacts in the future?

Better regulation is one of the key concerns of the new Commission – we believe that in terms of financial regulation this should translate into recognition and minimisation of the impact on end-users. We consider that the following changes are needed:

- ***Assessment of the impact of legislative measures on the real economy and early engagement*** between policy-makers, legislators and representatives of non-financial companies. Corporate treasurers deal with financial institutions, products and services on a daily basis and their voice should be heard when these are being regulated – because changes in the financial system also have fundamental impacts on the users. The impacts on end-users of financial services can be hard to perceive in advance as they are at the end of the financial industry's implementations of regulations and the financial firms' behavioural adaptations. Accordingly, there must be a willingness suitably to amend legislation, regulation and rules after experience with their effects and the consequential multi-stage behavioural changes become apparent.

- ***Non-financial companies should not be assumed by default to be the same as financial companies*** when financial regulation is being developed. In many ways the business of

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z

financial services is about regulation and they are organised accordingly – but non-financial services companies are about making widgets or servicing them. At the very least companies in the real economy do not have the same systemic importance, being more numerous, less correlated, less leveraged, and so on. Imposing financial sector obligations on non-financial companies is neither meaningful nor appropriate.
The compliance burden for such non-added value activity is considerable and legislators need to consider carefully whether the legislation being contemplated has true importance to the reduction of systemic risk and increase in financial stability or may, in the end, do more harm than good after all the effects are worked through.
Where corporates are caught by such regulations, it is important that sufficient time is allocated for compliance, recognising that lead in time is likely to be longer for NFCs than for FCs.

- There should be ***a more structured and sustained dialogue with non-financial companies – and in general, the real economy***. This could be done by more effective and timely consultation with representatives of non-financial companies and in general organisations other than those lobbying for the interests of the financial sector. There is also an urgent and continuing need for a more balanced composition of stakeholder groups such as the ESMA Securities and Markets Stakeholder Group (SMSG) – where there is currently no non-financial company representative.

- ***Flexibility should be built in to legislation where possible and appropriate***, so that modifications after experience is gained are relatively easily achieved and not grand projects themselves. The consequences of financial regulation for end-users are hard to predict and may emerge only after rules come into effect, sometimes being realised only later in economic cycles.

afte - 3, rue d'Edimbourg - CS40011 - 75008 Paris - Tél. 01 42 81 53 98 - Fax 01 42 81 58 55 - afte@afte.com - www.afte.com
Association régie par la loi du 1er juillet 1901 - Journal officiel du 17 novembre 1976 - N° de siret 314 974 338 000 68 - Code Ape 9499z