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Association française des marchés financiers

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Editorial

Investment research is a matter of huge importance for companies that raise funds on capital markets. Not only is research essential for maintaining investor interest; it also plays a crucial role in stimulating dialogue and thus lowering the cost of capital for issuers. That is why the French public authorities and the securities regulator, the AMF, have been trying for years to find ways of increasing the amount of research on small and medium sized enterprises (SMEs) and mid-tier companies, which is often lacking. Furthermore, in the working document accompanying the Green Paper on Capital Markets Union (CMU, see Feature), the European Commission noted that much less research is done on these firms than on large-caps and that the issue ought to be addressed. The fact that their access to market funding is a key aspect of the CMU makes the issue especially important.

Yet, at the same time the Commission is considering heeding proposals from the European Securities and Markets Authority that would seriously undermine the economic viability of an activity already shaken by the crisis. The proposals, which have been strongly challenged by the entire industry, would place heavy constraints on asset management companies that source research from market intermediaries. This, in turn, would reduce existing production capacity still further. And small, medium and mid-tier companies would bear the brunt *(AMAFI / 15-10).*

True, there are regulatory concerns to be taken into consideration. But the economic realities cannot be ignored. Growth is badly needed, now more than ever. Which means that companies in general, and SMEs and mid-tier companies in particular, must have unfettered access to market-based financing. In consequence, the proposals made by the Commission and ESMA have to be rationalised. AMAFI and its European counterparts have been working for many weeks to make this happen.

Pierre de Lauzun
Chief Executive, AMAFI

Capital Markets Union: A New Deal?

Feature


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With Europe's economy still sluggish, solutions for injecting a bit of dynamism are much in demand. Consequently, recent proposals for a Capital Markets Union have made a splash. The project is still in the teething stage but reactions have been broadly positive.

"Over time, I believe we should complement the new European rules for banks with a Capital Markets Union." So wrote Jean-Claude Juncker before taking over as European Commission President. Mr Juncker believes Europe's capital markets should be further developed and integrated in order to cut the cost of capital raising, especially for small and midsized enterprises (SMEs), and to reduce reliance on bank funding.

UK Commissioner Jonathan Hill was tasked with "bringing about a well-regulated and integrated Capital Markets Union (CMU), encompassing all Member States by 2019 with a real view to maximising the benefits of capital markets and non-bank financial institutions for the real economy".

Feature

The logic behind the CMU project is a growing awareness that European companies have generally relied too heavily on banks, which supply between 70 and 80 per cent of funding to the economy, and much less on capital markets. (By comparison, 80 per cent of funding in the United States is market-derived.) Since the onset of the financial crisis, businesses in general and SMEs in particular have realised that they need to diversify their sources of funding. This is especially true now that banks are balance sheet-constrained by prudential regulations and are no longer able to meet strong demand for funding. The problem would be compounded if growth were to pick up. A CMU would go some way to addressing this problem. It would also attract more inward investment to the European Union and make the financial system more stable by opening up a wider range of funding sources. And it would underscore the benefits of capital markets for the economy, jobs and growth.

From theory to practice

How will a CMU work in practice? Responding to questions from the EU's Economic and Monetary Affairs Committee, Lord Hill said he would pursue three objectives: creating a single market for European financial instruments to encourage funding for SMEs and long-term projects, including securitisation and private placement; deepening the single rulebook; and utilising the existing supervisory framework to improve supervisory convergence, protect investors and improve the transparency of supervision-related information.

A detailed action plan is due to be published in the course of 2015 but the Commission has made it plain from the outset that building a CMU is a long-term project. And while expectations are high, interpretations differ. According to Yves Mersch, a member of the Executive Board of the European Central Bank, "There is no common understanding of what [CMU] means or what it should look like". One American commentator was less politic, saying that although Europe's policymakers had come up with a new idea, they still "had to figure out what it means". Some of the details have been spelled out clearly, both by policymakers (the EU published a Green Paper in February) and by market participants. They include the need to ease transparency and reporting requirements for listed companies, develop securitisation, overhaul corporate governance, harmonise shareholders' rights and expand private capital markets. Another key issue is to design a centralised European information system on SMEs and mid-tier companies.
Naturally, all of this is more of a wish-list than a set of specific policies; and not all these aims can or will be achieved in the near future. But acknowledging that capital markets are important for growth in Europe is already a major step forward. Nevertheless, a tighter focus would be welcome.

Change the perspective

For the past two decades, market integration has been a constant theme in Europe, which has passed a raft of legislation and regulation to bring it about. The received wisdom is that opening up borders and fostering competition will boost activity and drive growth. From a capital market perspective, European integration has been designed and implemented with major corporations in mind. But Europe's economy is dominated by smaller businesses: two-thirds of private-sector jobs are with SMEs and mid-tier companies, which do not enjoy fast-track access to market funding.

As bank financing becomes thinner on the ground, non-large caps need to be able to raise money locally because, despite the rhetoric, a Europe-wide framework would not automatically mean that a firm incorporated in, say, Poland will attract Dutch investors. For that reason, alternative and – above all – local sources of financing are absolutely vital. Expanding the securitisation market is certainly one promising avenue to explore. Spurred by the financial crisis, regulators have clamped down on securitisation, requiring banks and other originators to hold onto part of the loan and set aside larger amounts of capital. Banks have protested that the capital could be used for lending, and they argue that the rules on securitisation should be relaxed.

In the current context, harmonisation and convergence are laudable objectives that should be pursued. As far as growth is concerned, however, they are just that – objectives rather than immediate priorities, because they will take a long time to achieve. What is needed right away are measures to enhance the role of markets, make them more efficient and enable them to provide funding for local economies. For SMEs, markets work on the basis of home-grown ecosystems, which could be jeopardised if convergence were to become the be-all and end-all of a CMU. Given the current state of market integration in Europe, and in addition to long-term convergence, an ambitious CMU should serve the objective of establishing an open architecture serving a multiplicity of ecosystems, notably at the local level. This will not be the case if the overarching design principle is convergence.

Two hurdles

Two main hurdles must be avoided when designing and building an integrated CMU. First, integration could easily become synonymous with concentration, thus defeating the initial objective of the project. The process of building an integrated market, particularly when the constraints have intensified sharply as a result of the crisis, has tipped the balance in favour of major global participants, which are better able to adjust. This in turn is resulting in greater concentration at the expense of local ecosystems. If this trend were to be exacerbated by a dash for even greater concentration, it could spell the end of locally based funding. What Europe needs above all is efficient and diversified financial markets.

The second hurdle is just as a perilous: making integration synonymous with uniformity and defining competition in abstract terms. The practical limits to integration lie in the institutional, cultural and social framework of Europe's member states, so if the thrust of CMU is to achieve uniformity, then it is small and medium sized firms that will lose out. True, a union should enable the development of market-based financing models that meet the needs of all types of issuers and investors. But in view of the political and economic realities in Europe, it is crucial to promote diversified and liquid local markets, which are best able to address the needs of SMEs and local investors.

Paradigm shift

Despite the thorny issues that will have to be resolved, the consensus view on a CMU seems to be largely favourable, even among commentators who generally scoff at grand European plans. There is, however, a feeling that harmonisation in Europe tends to work upwards to the highest level, so that any genuine effort at reform will have to come from national governments.

By and large, Europe should adopt a regulatory system that would encourage the development and orderly operation of markets by ensuring proper security, investor protection, a diversity of market models and a framework designed specifically for SMEs and mid-tier companies, but also serving a variety of ecosystems. What's more, any existing rules and laws that might stunt the development of the European economy can and should be revisited, especially if they impose top-heavy prudential or disclosure requirements.

An effort will also have to be made to convince countries such as the UK that a CMU would be a booster for growth rather than a snarl of red tape. Organisations ranging from the BBA to the Bank of England have voiced approval in principle.

In sum, the move towards broader and deeper capital markets has been welcomed on the whole because it mirrors a belief that the emphasis must be shifted from regulating capital markets to developing them. As for the outcome, only time will tell. The most remarkable aspect of the CMU project is that, for the first time since the onset of the financial crisis, markets are being viewed as a force for economic good.

Anthony Bulger

Q&A with...

Pierre de Lauzun, Chief Executive, AMAFI

Is a Capital Markets Union a good way to revive economic growth?

Any initiatives to develop markets and make them more efficient are very welcome. But the aim must be clear. What are the measures that will improve financing for the European economy? And what kind of markets does Europe need? Those are the key issues. So the CMU will be beneficial if it translates into positive actions that foster growth.

What are AMAFI's proposals?

In our view, there are several main priorities. First, a common framework for SMEs and mid-tier companies must be put in place. Second, Europe needs a common framework for securitisation, which must be effective and perceived as not only positive but vital. Third, steps must be taken to encourage alternative investments such as the Euro Private Placement and marketable debt instruments, which should be harmonised by currency area. Next, we must contribute to establishing long-term investors in order to consolidate European share ownership, in particular through pension funds. Last but not least, Europe needs a specially designed framework for commodities markets, as well as tools to ensure that market infrastructures are both secure and resilient.

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MiFID 2

On 19 December, ESMA began a public consultation on its draft technical standards for MiFID 2 implementation. The topics raised were the subject of an earlier consultation in a discussion paper issued by ESMA on 22 May *(AMAFI / 14-29)*.

AMAFI concentrated on several points in its feedback *(AMAFI / 15-17)*:

- As the proposals stand, the new non-equity transparency arrangements are highly questionable, particularly in terms of the definition of liquid markets for each class and sub-class of instruments. The proposed approach ignores questions of orderly market operation by qualifying as liquid many instruments that ESMA itself considers to be illiquid. ESMA needs to review these thresholds to significantly reduce the number of false positive readings, where instruments are classified as liquid whereas they are not in fact. To be able to examine ESMA's proposals more closely and offer realistic alternatives, AMAFI and its fellow organisations in Germany, Denmark, Spain, Italy and Sweden wrote a co-signed letter to Jonathan Hill, the European Commissioner with responsibility for the financial sector, asking for access to the data used by ESMA in its quantitative work.
- The many best execution obligations are disproportionate and introduce numerous new fields that are costly to process while providing information whose usefulness has not been demonstrated.
- The regulatory reporting obligations are cumbersome and will have an excessive impact on institutions' IT systems relative to the objectives.
- The electronic trading obligations are extremely detailed and strict, and many of them are ill-suited to real-life practicalities. Moreover, their treatment of market abuse prevention and Know-Your-Client requirements clashes with the specific rules on these subjects.
- For commodity derivative markets, AMAFI identified problems in terms of the definition of an ancillary activity, which determines the scope of MiFID application for non-financial participants on these markets, and in terms of the arrangements for position limits and reporting.

Following the consultation, ESMA will send draft Regulatory Technical Standards and Implementing Technical Standards to the European Commission before 3 July 2015 and 3 January 2016 respectively.

AMAFI also criticised the approach taken in several of the technical advice notices sent by ESMA to the Commission on 19 December, based on which the Commission will prepare delegated acts over the course of the year. AMAFI set out its main concerns in a document sent to members of the European Parliament in January *(AMAFI / 15-05)*. These included the arrangements for paying for financial analysis, the definition of high-frequency trading in relation to market making, product governance and customer information about costs and charges.

However, AMAFI concentrated its efforts on the question of paying for investment research, which it viewed as the most pressing matter. It teamed up with its German, Danish and Italian counterparts to draft a document drawing the attention of the European authorities to this issue (see Editorial). As it stands, ESMA's position should be rejected and replaced by a more realistic approach based on enhanced transparency and disclosure of the costs of research *(AMAFI / 15-10)*.

Véronique Donnadieu, Emmanuel de Fournoux, Stéphanie Hubert, Victor Maurin

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Market discipline

On 19 February, AMAFI and AFTI issued a joint response *(AMAFI / 15-14)* to ESMA's consultation paper on technical standards for the Central Securities Depositories Regulation. AMAFI reiterated its call for the penalty regime to be effective in a timeframe compatible with implementation of the TARGET2 Securities system scheduled for early 2018.

The regime proposed by ESMA, based on penalties applied to gross positions, is not satisfactory because it fails to properly address the fact that the settlement system operates largely based on net positions. Furthermore, the buy-in mechanism does not look workable because no clear definition is provided on what this type of procedure should include.

Emmanuel de Fournoux, Victor Maurin

Benchmark indices

On 13 February, the Permanent Representatives Committee for the EU Council (Coreper) endorsed the draft regulation proposed by the Latvian presidency. Meanwhile, the European Parliament's Committee on Economic and Monetary Affairs (ECON) is set to take a stance on a draft document based on the draft report by Rapporteur Cora van Nieuwenhuizen. Once this is done, trialogue negotiations can begin.

AMAFI's main concern involves in-house benchmarks. Here, the Rapporteur's proposals differ from the approach adopted by the Council by offering welcome flexibility on the requirements for these non-critical indices. AMAFI will keep a close eye on progress in the trialogue.

Stéphanie Hubert

PRIIPS

The Joint Committee of European Supervisory Authorities has published Level 2 measures for the Regulation on Packaged Retail and Insurance-based Investment Products (PRIIPS). The measures cover the content of the key information document that must be provided to retail investors in PRIIPS, which include structured products, derivatives, convertible bonds, unit-linked insurance contracts and, in due course, UCITS and AIFs.

AMAFI issued a paper stressing the need for scalable solutions given the unprecedented number of financial instruments involved *(AMAFI / 15-12)*. It also challenged the proposed inclusion of convertible bonds and certain derivatives in the scope of the regulation. AMAFI drew the Joint Committee's attention to the publication timetable for Level 2 measures, pointing out the lack of time for adequate implementation and the resulting need for a transition period. Another, more technically-focused consultation will be held in the spring, with proposed technical measures to be released in the autumn.

AMAFI is also taking part in industry-wide meetings organised by French authorities to allow stakeholders to agree on a shared approach. As part of this, AMAFI continues to promote a methodology for calculating the risk indicator *(AMAFI / 15-11)* that applies to all PRIIPS, provides investors with useful information and that can be easily replicated to make it easier to implement and check.

Stéphanie Hubert, Julien Perrier

Remuneration

The European Banking Authority (EBA) has released its draft guidelines on CRD4 remuneration provisions. The publication came out of a review of the 2010 guidelines issued by the Committee of European Banking Supervisors (CEBS), which banks and authorities used as a basis to interpret the procedures for applying the proportionality principle.

In its draft, EBA effectively challenges the previous CEBS interpretation by saying that the proportionality principle cannot result in non-application of CRD4 remuneration measures, including deferral, payment in instruments, a cap on variable payment, and malus provisions, even by smaller and non-complex banks. Accordingly, it states that institutions should at least apply the minimum thresholds set out in CRD4.

The draft guidelines also clarify the criteria for allocating elements of remuneration to the fixed and variable components, considering there to be no other remuneration categories (including the role-based allowances introduced by some institutions, for example).

Aware of the potential impact of its guidelines, EBA particularly asked for feedback from stakeholders about the consequences for small and less complex institutions. In its response, AMAFI will stress the need to maintain a truly proportionate approach for financial sector SMEs and avoid the risk of further sector concentration.

Stéphanie Hubert

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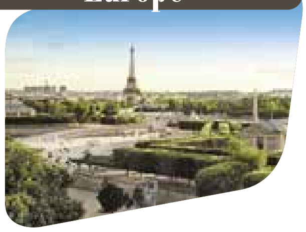

EFSA meeting, Paris, 11-12 March 2015

The European Forum of Securities Associations (EFSA) includes organisations representing market participants in Denmark, France, Germany, Italy, Poland, Spain, Sweden and the UK. AMAFI hosted EFSA's meeting on 11 and 12 March 2015 in Paris, which provided an opportunity to talk about a wide range of topical issues.

Particular attention was paid to joint initiatives in relation to the preparation of MiFID Level 2 measures. Discussions also covered the draft financial transaction tax and related issues for market making, as well as the proposed Capital Markets Union.

Véronique Donnadieu

France

Agricultural commodity derivatives

The Banking Separation and Regulation Act of 27 July 2013 required the AMF to set up a system of limits on positions in financial instruments whose underlying is an agricultural commodity. The legislation also provides for reporting and publication of these positions under certain conditions. To implement the system, which will apply from 1 July 2015, the AMF began a consultation in late December 2014 on a draft instruction and proposed amendments to its General Regulation.

In addition to making some wording suggestions *(AMAFI / 15-15)*, AMAFI stressed the need to:

- take proper account of the European and competitive setting into which France's system is to be introduced;
- clarify the scope of application as regards those subject to the system and reporting channels;
- have flexibility in the limit review procedures;
- review some of the proposed limits.

Véronique Donnadieu

Inaugural Euro PP meeting on 13 March 2015

© Romain Baltz

The inaugural Euro Private Placement (PP) meeting was held on 13 March, following publication at the start of the year of model agreements for loan and note formats (available on the AMAFI website and at www.euro-privateplacement.com), which in turn followed the 2014 publication of the Euro PP Charter. Attracting more than 400 participants, the gathering was the first large-scale event devoted to the private placement market and was organised by the ten industry associations that signed up to the Charter, with the support of several public authorities, including the Treasury, the Banque de France and the Paris Ile-de-France Chamber of Commerce and Industry.

Delegates, who included representatives from every category of PP market participant, got the chance to share their experiences and views in workshops and panel discussions and to talk together about the European prospects for this fast-growing market. The Governor of the Banque de France gave the closing address. The steering committee is to meet shortly to decide on the next steps to promote the market's expansion at home and internationally. Already on the list are plans to stage a repeat event in 2016 to build on the success of the inaugural Euro PP Meeting.

Sylvie Dariosecq

News

Taxation

FTT

French President François Hollande gave renewed political impetus to the financial transaction tax (FTT) initiative in early January 2015. His support was followed up by a Franco-Austrian initiative, with the result that Member States engaged in enhanced cooperation have renewed their commitment to the FTT. The stated goal is to have the tax enter into force on 1 January 2016 based on the widest possible base and low rates, while taking full account of the impact on the real economy and the risk that financial sector activities could relocate.

The working method has been reviewed, with Austria taking charge of the permanent presidency, Portugal running the technical secretariat, and Commission staff providing support. Greater transparency is also expected, notably towards non-participating Member States, which assumes that documentation will be produced regularly on the progress made.

AMAFI naturally continues to devote considerable energy to this issue, which will have a decisive impact on the future of the Paris financial centre. After raising concerns about the legal and economic risks connected with taxing derivatives, AMAFI recently warned European Commissioner Pierre Moscovici about plans to make market making liable for the FTT. Such a move would effectively create a chain of taxation that could destroy this activity, which is vital to orderly markets, or force it out of the area comprising the 11 Member States that engage in enhanced cooperation.

Eric Vacher

Amafi Highlights

New Members

EOS Venture is an investment firm that specialises in crowdfunding through securities investment. It manages the Letitseed platform, which seeks to raise capital over the internet to fund start-ups and SMEs. Its senior managers are Stéphane Lubiarz (Chairman) and Nicolas Charlet (CEO).

EPEX SPOT is a European power exchange that manages day-ahead and intraday spot power markets for France, Germany, Austria and Switzerland. Registered as a European Company, EPEX SPOT is based in Paris with branches in Leipzig, Berne and Vienna. It is managed by Jean-François Conil-Lacoste (Chairman of the Management Board).

Pierre de Lauzun receives an international award for his book "Finance: un regard chrétien"

The Centesimus Annus – Pro Pontifice Foundation has awarded its international Economy and Society prize to AMAFI Chief Executive Pierre de Lauzun for his book "**Finance, un regard chrétien. De la banque médiévale à la mondialisation financière**" (Ed. Embrasure, 2013).

The prize will be awarded on 26 May in Rome in the presence of Cardinal Pietro Parolin, Vatican Secretary of State.

The Centesimus Annus – Pro Pontifice Foundation's goal is to spread awareness about the Catholic Church's social doctrine.

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AMAFI documents quoted in this Newsletter and flagged with a reference number are on our website at
www.amafi.fr
Most of them, notably AMAFI's responses to public consultations, are freely available, but some are restricted to members only.

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