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Editorial

Since the AMAFI Board has done me the honour of appointing me as chairman, my first official act will be to pay tribute to my predecessor, Philippe Tibi. Under Philippe's leadership, AMAFI continued to enhance its credibility and make substantive contributions to the many regulatory issues that market participants have had to deal with in the past five years or more. As our industry reached a critical juncture, AMAFI was able to take an increasingly public stance, tirelessly emphasising the importance of a strong financial centre capable of catering to the sundry needs of companies, both large and small, and investors.

The credibility AMAFI has gained and the audience it has won are especially vital today as the Paris financial centre enters a critical period. The unparalleled economic and financial crisis that erupted in 2008 is still rumbling on. And financial institutions are facing an unprecedented raft of new regulations, often drafted in haste and with scant regard for the combined impact on the financing of economic activity. Yet finance is the driving force needed to revive business investment and hence growth.

The tougher the situation, the greater the need for a strong voice to articulate the crucial role played by markets and their participants. You can rest assured that, with the support of the Board, Pierre de Lauzun, Bertrand de Saint Mars and the entire staff, I will do everything in my power to make AMAFI that strong voice.

Stéphane Giordano
Chairman, AMAFI

Feature

French paradox redux

For a nation reputedly hostile to the worlds of economics and finance, France has produced some of the brightest exponents in both fields. But does theory translate into practice?

With headlines ranging from "the time-bomb at the heart of Europe" to "an economic basket case", the English-language press pulls no punches when describing France and its economy. The French themselves tend to be a glum bunch. The latest Sage index, which surveys some 14,000 European SMEs, showed business confidence in the UK and Germany at 66 and 63 points, respectively, compared with just 55 in France. And not a day goes by without a damning article or an editorial broadside in the national media against the country's anti-business culture or economic illiteracy.

Yet the new Nobel prizewinner in economics, Jean Tirole, is French. As is the headline-grabbing economist Thomas Piketty. Meanwhile a French woman, Christine Lagarde, heads the International Monetary Fund; her compatriot Xavier Rolet runs the London Stock Exchange; and many large corporations – including the European arm of Coca-Cola – are run by French executives. Is this yet another French paradox? ▸

Feature

The not-too-dismal scientists

France has a long tradition of excellence in economics, going back to Antoine de Montchrestien, who coined the phrase 'political economy' in the 17th century. Other influential historical figures include Jean-Baptiste Say and his "law of markets", and Léon Walras, who developed the marginal theory of value.

The tradition is still very much alive. Most recently, Jean Tirole, a specialist in industrial organisation, was awarded the 2014 Nobel Prize in economics for his work on market power and regulation. The Nobel Committee described him as "one of the most influential economists of our time" for his insights into the taming of powerful firms. Tirole's work on industrial organisation is widely recognised for overturning conventional wisdom and reaching conclusions of great practical significance.

Possibly better known than Jean Tirole is the economist Thomas Piketty, described by no lesser authority than the *Financial Times* as a "rock star ". Hyperbole aside, Piketty's 700-page book, translated into English as "Capital in the 21st Century", has topped the best-seller lists on both sides of the Atlantic — almost unheard-of for a dense economic treatise — and propelled its author to the forefront of a frenzied debate on inequality and the morality of capitalism.

If Tirole and Piketty are the headline acts, the supporting cast is equally impressive. For example, the IMF recently published a list of economists "who are shaping the way we think about the global economy". Of the 25 names, seven (including Piketty) are from France, more than any other country apart from the US. They include Esther Duflo, a professor at the Massachusetts Institute of Technology appointed by President Barack Obama to advise on global development policy. Duflo has also been singled out by *Time* magazine as one of the 100 most influential people in the world. Another high-profile name is Hélène Rey, a professor of economics at the London Business School and a member of the council of economic advisers to the French president.

The success of the French approach to economics may be due to the fact that it blends mathematics and statistics with sociology, psychology, history and even popular culture. For instance, Piketty's "Capital" draws on literary giants Balzac and Austen but also cites Tarantino and the movie "Titanic".

Another success factor is the work of two rival institutions: the Toulouse School of Economics, chaired by Jean Tirole, and the Paris School of Economics, where Thomas Piketty teaches. According to the RePEc worldwide ranking of economic research, the PSE ranks seventh and the TSE eleventh.

French they may be, but both schools have English names and use English as the main or only teaching language. And, with the exception of Piketty, all the French economists singled out by the IMF work outside France, either in the UK or the US.

The quant connection

Another area of French expertise is financial mathematics. Maths, like economics, has a storied tradition in France, stretching from Fermat and Pascal in the 17th century to Schapira and Vilani today. The combination of maths and finance is largely due to one man, Louis Bachelier, who blended the two disciplines as long ago as 1900 with his thesis on speculation and Brownian motion. To many, Bachelier is the father of modern finance, though his fame was a long time coming.

QUANTS IN A POST-CRISIS WORLD

"Quants learn how to model uncertainty" says Michel Crouhy, Head of Research and Development at Natixis. Quantitative analysts have a dual role: to design and develop models for pricing and trading securities and derivatives and to manage risk. Since the onset of the financial crisis in 2008 the latter disciple has come to the fore, in part because quants were made to shoulder some of the blame for the market meltdown. In sum, the crisis put an end to the race for sophistication. The emphasis today has shifted to devising indicators for identifying and measuring short- and medium-term risk in order to anticipate how the prices of financial instruments will move. According to Frédéric Abergel, Chair of Quantitative Finance at Ecole Centrale de Paris, "Clients are now looking for simpler products that are better attuned to economic realities. Although the crisis wasn't caused by quants it did reveal a dangerous drift, where time pressure and business necessity made it tempting to predict future outcomes. In fact, what quants should aim to do is keep risk under control". According to Michel Crouhy, quants play a pivotal role in financial innovation and risk management and will be increasingly in demand.

Feature

As finance became more and more complex, with the development of derivatives and the opening of specialised markets in sophisticated instruments, Bachelier's work was extended by US economists such as Robert Merton and Fischer Black to form the basis of option pricing theory. This subsequently paved the way for dynamic investment strategies, as opposed to the standard techniques of ensuring an average risk by weighting different asset classes. These new strategies are now the bedrock of modern finance and financial innovation.

One pioneer in financial maths is Nicole El Karoui, who teaches at Pierre and Marie Curie University in Paris. Professor Karoui, who is also research director at the centre for applied mathematics at the prestigious Ecole Polytechnique, teaches a postgraduate course in Probability and Finance that has become a huge draw for students seeking to master the complexities of derivatives and become quantitative analysts, or "quants" (*see box page 2*).

In addition to the intellectual satisfaction of mastering sophisticated financial instruments, graduates who complete Ms Karoui's programme are much in demand from banks and other institutions both in France and worldwide. Such is the programme's reputation that recruiters vie to attract graduates to their trading rooms and research departments. Many French-trained quants head off to destinations such as New York, London or Singapore, though some stay in France or return to work in the hedge fund industry, which is being promoted through industry-led initiatives such as QuantValley and the Quantitative Management Initiative.

How to resolve the paradox?

Nobelists and celebrities aside, there is no denying that the French in general are ill-informed about economics. More importantly, the country's dominant culture is resolutely anti-business.

An unscientific, but enlightening, web search for references to a lack of economic and financial understanding in France yields more than a million hits. The tone of the articles is generally admonishing, sometimes breast-beating and occasionally highly critical. Much of the recent commentary has focused on the latest OECD Programme for International Student Assessment (PISA) survey of financial literacy of 15-year-old students, which found that France's performance was below the average of the countries taking part in the assessment. Over 19 per cent of students fail to reach baseline proficiency level, compared with an OECD average of 15.3 per cent. According to the PISA findings, France's overall performance falls short of expectations, based on students' skills in maths and reading. This suggests that the core skills acquired in schools are not enough to provide young French people with the necessary knowledge and understanding of financial concepts and risks.

It is not only high school students who struggle to decipher the fundamentals of finance. A survey of adults by the business school Audencia posed 26 basic questions about economics and personal financial management to a group of adults. The average score was 5.04 on 10. Interestingly, Audencia's findings reflect those of a similar survey conducted three years earlier by Credoc. And so on and so forth.

The roots of this unfamiliarity are cultural and political. Wedded to the idea of a strong state, the French innately mistrust free markets and are hostile to the financial world in general. An Ifop survey in 2010 asked respondents in six countries whether capitalism worked well and ought to be preserved. Only 15 per cent of respondents in France answered yes, compared with 55 per cent in the US, 45 per cent in the UK and 65 per cent in China. This anti-financial culture is nourished by politics, on both sides of the left-right divide. When François Hollande said in 2012 that finance was his "main adversary", he was echoing Charles de Gaulle, who in 1969 proclaimed that money had always been his enemy – and the enemy of France. Other prominent figures regularly voice similar views.

How to resolve this divide between theory and practice? The issue is vitally important. Nobel prize-winning economist Edmond Phelps has said that lifting the general level of financial literacy in France could boost potential economic growth by 3-4 per cent. Efforts have been made to improve the situation. Economics has been made an obligatory subject for 15-year-olds in schools. And institutions such as the IEFP are working on public financial education.

Much more needs to be done, however, at both public and private-sector levels. One of AMAFI's missions is to raise awareness of the essential role of financial markets, particularly at a time when governments are pulling back on funding. Along with other industry players, the Association is campaigning on the need to channel personal savings into the financing of companies and business activities. Changing an entrenched culture will be a lengthy undertaking. Perhaps France's recent high-profile successes will make the task a little easier.

Anthony Bulger

News

Europe

EFSA meeting, Copenhagen, 23-24 October 2014

The European Forum of Securities Associations (EFSA) is an informal group of industry organisations from the UK (AFME), France (AMAFI), Spain (AMF), Italy (ASSOSIM), Germany (BWF), Denmark (DSDA), Poland (IDM) and Sweden (SSDA). It meets approximately twice a year to discuss issues of common interest.

The latest meeting was organised by DSDA in Copenhagen on 23 and 24 October 2014. Top of the agenda was the work being done by EFSA members to prepare Level 2 measures for the Market Abuse Regulation and the Markets in Financial Instruments Directive and Regulation. Given the extremely short timeframe for drafting the associated implementing measures, especially on non-equity market transparency, there are serious doubts whether the objectives can be met without disrupting the orderly functioning of the mechanisms in question. The delegates at the meeting also stressed that the impact study of ESMA's planned measures was being conducted in such a way that ruled out a thorough or credible evaluation.

Véronique Donnadieu

EMIR

Asset classes eligible for clearing

ESMA launched a consultation on 1 October on the clearing of non-deliverable forwards, used to hedge non-convertible currencies. Responding, AMAFI said it was untimely to impose a clearing obligation on these derivatives, which have low systemic risk. Moreover, in Europe, NDFs are cleared by a single clearing house and only a handful of clearers (*AMAFI / 14-46*).
ESMA also published a final report on the draft technical standard on over-the-counter interest rate derivatives. Following up on a consultation held this summer, ESMA added an additional category of counterparties, as requested by AMAFI in its response to the consultation (*AMAFI / 14-30*).

Emmanuel de Fournoux, Victor Maurin

AMAFI Q&A updated

AMAFI has again updated the Q&A covering implementation of EMIR and its delegated regulations. For this new version (*AMAFI / 14-44*) the Legal Committee has incorporated not only the issues addressed since the Q&A was last published but also the responses made by the European Commission and various national and global regulators during this period. The latest amendments chiefly concern the scope of EMIR and the enforcement of its obligations, notably dispute settlement and the requirement to report trades to a central repository.

Sylvie Dariosecq, Julien Perrier

News

Europe

Settlement period shortened from T+3 to T+2

In compliance with the Central Securities Depositories Regulation, all European markets apart from Spain have now shortened the period for settling securities trades on stock exchanges or other regulated markets from three days after the trading day (T+3) to two (T+2). The adjustment was smooth and so far there is no evidence of a decline in settlement quality, at least in France. For intermediaries the advantage of the reform is that, by mitigating counterparty risk, it reduces the amount of collateral to be posted at clearing houses.

Emmanuel de Fournoux, Victor Maurin

Market abuse

ESMA has issued a consultation on the draft technical standards and technical advice it intends to submit to the European Commission, following up on this January's consultation on the forthcoming Level 2 measures under the Market Abuse Directive. In its response, AMAFI commented on a range of issues, notably market soundings, suspicious transaction reporting, share buyback programmes, stabilisation of financial instruments, market manipulation indicators, insider lists, financial analysis and accepted market practices (*AMAFI / 14-42 and 14-43*).

Stéphanie Hubert, Julien Perrier

France

Business financing - Euro PP and MMIs

The industry is moving ahead with work on the Euro PP (*see feature in AMAFI Financial Newsletter No 23*) and the money market instrument market, at the behest of the Banque de France and the Treasury.

Standard contracts for Euro PP bond issues and loans are being drawn up, and in-depth discussions are underway on a range of technical issues. The work is being done with the support of a steering committee in which AMAFI plays an important part. The aim is to do everything possible to make Euro PP transactions more attractive and easier to implement for corporates, especially midsized companies,. In addition, a forum will be held on 13 March 2015 which should allow issuers, investors, intermediaries and lawyers to share their insights on future prospects for this market and gather information on the latest developments on the Euro PP front. To underscore the importance of the event, the closing address will be given by Banque de France Governor Christian Noyer.

Regarding money market instruments, a series of key practical proposals are being readied for presentation to the Paris Marketplace Committee 2020. The thrust is to make the MMI market more attractive, particularly to global investors, in view of its strategic importance for the French economy as a whole.

Sylvie Dariosecq

News

France

Charging for market data

The steep rise in the price of data has been a headache for market participants in recent years. A member survey by AMAFI in June confirmed the cost hike and also showed that the prices charged by trading platforms and data vendors are non-transparent and highly complex. This in turn has inflated data users' management costs.

At the regulatory level, ESMA is preparing implementing measures for the MiFID 2 package, which states that data should be supplied "on a reasonable commercial basis". Be that as it may, some of ESMA's ideas are disappointing because they could mean that platforms' costs and revenues are placed under surveillance. This would be inappropriate for a model organised around free competition among industry participants.

Further to discussions in its Market Structure Committee, AMAFI is advocating an alternative approach based on self-regulation, whereby trading platforms and data vendors would follow best practices in order to lower costs and bring pricing principles into line (*AMAFI / 14-50*). AMAFI has voiced its views to the European Commission and ESMA.

Emmanuel de Fournoux, Victor Maurin

Initial public offerings

The French securities regulator, the AMF, has consulted on proposed amendments to two articles of its General Regulation and the publication of a Position-Recommendation. The aim is to implement the proposals of a working group that looked at the regulatory treatment of IPOs in France and to draw comparisons with other European countries.
AMAFI welcomed the AMF's initiative and praised the working group's final report (*AMAFI / 14-45*). Some of the proposals are a major step forward in areas that have long been a concern for its Corporate Finance Committee. On other matters, however, AMAFI regrets that France still imposes constraints that do not exist elsewhere in Europe, such as pricing rules, a single prospectus and a mandatory retail tranche. Also, several of the articles in the General Regulation ought to be redrafted in order to see the initiative through to its logical conclusion. This applies in particular to Article 315-35, on the treatment of retail investors, which poses interpretational problems and is at odds with the objectives of the working group.

Sylvie Dariosecq, Julien Perrier

Transposition of the Statutory Audit Directive

The justice ministry began work several weeks ago on transposing Directive 2014/56/EU and adapting French law to accommodate Regulation (EU) No. 537/2014, both dated 16 April 2014. This has raised questions about so-called public-interest entities (PIEs) – a concept that determines the scope of both texts – since some of the measures entail serious constraints.
Although investment firms are not automatically defined as PIEs, member states have the possibility of extending this category to other entities. AMAFI is therefore concerned that the option should not be used overzealously when identifying PIEs, defined in the directive as "undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees". Particular attention needs to be paid to the position of French firms relative to their foreign counterparts, especially since the finance ministry has asked the Paris Marketplace Committee 2020 to identify ways of making the market and its participants more competitive. At the very least a threshold should be set, above which investment firms would not be concerned by the measure. But this should not be done before examining what other member states plan to do. AMAFI has drawn the attention of the Treasury to this issue.

Sylvie Dariosecq

Risk takers' remuneration

France has transposed the CRD4 rules on risk takers' remuneration into law. The measures are ordained by a decree and an executive order dated 3 November 2014, which establish technical implementation provisions on matters such as the content of resolutions submitted to annual general meetings and the types of financial instruments that can be used for variable remuneration. Other stipulations include the arrangements for applying the proportionality principle, in compliance with CRD4. While the preparatory work was underway, AMAFI insisted on the need to ensure that the rules do not skew the playing field against smaller firms and are consistent with the measures taken by other European countries.

Stéphanie Hubert

Taxation

News

European financial transaction tax

Writing in the business daily *Les Echos* ahead of the recent Ecofin meeting, the French finance minister, Michel Sapin, gave details of the country's proposals on the European financial transaction tax (FTT):

- taxation of trades in listed equities and unlisted shares (the latter as an option available to all participating Member States)
- taxation of non-cleared CDS
- taxation based on the issuance principle, but with the proceeds allocated according to the residence principle.

Although this plan does not overcome the drawbacks arising from the fact that only 11 Member States will levy the FTT, it does mitigate the crowding-out effect inherent in other possible solutions. For France the negative impacts would be palpable, notably the fact that business and trading would migrate elsewhere, leading to job losses and foregone tax revenues and social security contributions.

Discussions are due to resume at the forthcoming Ecofin meeting in mid-December.

Eric Vacher

Automatic exchange of information

An inter-governmental agreement between France and the USA to enforce the Foreign Account Tax Compliance Act (FATCA) has been ratified by Act 2014-1098 of 29 September 2014. Designed to combat tax evasion, the agreement establishes bilateral cooperation between the US and French tax authorities for the automatic exchange of information (AEI), a measure already adopted by Germany, Spain and the UK.

Back in July the OECD published an international AEI standard based on FATCA agreements. The standard was adopted in Berlin in late October 2014 by all OECD and G20 countries as well as by major global financial centres. In all, nearly a hundred countries have undertaken to implement AEI in the near future: by September 2017 in most cases and by September 2018 at the latest. In addition to the countries usually involved in international cooperation, the signatories include Andorra, Anguilla, the Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, Hong Kong, Macao, Monaco, Singapore and Switzerland. This confirms a fundamental global trend to enhance tax transparency.

In Europe, Ecofin announced on 14 October 2014 that it was amending Directive 2011/16/EU on enhanced cooperation in the field of direct taxation, in order to incorporate the Savings Directive and establish the legal basis for Europe's new AEI standard.

These national, European and international AEI arrangements are all based on FATCA but governed by different laws and regulations. Investment firms and other institutions will now have to incorporate them into their IT systems, a process that will entail technological, cost and compliance issues.

For more information visit www.amafi.fr under Library

Eric Vacher

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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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