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The European Federation of Financial Services Users
Fédération Européenne des Usagers des Services Financiers

EuroFinUse's Response to the Green Paper on Long-Term Financing of the European Economy

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Executive Summary

The European Federation of Financial Services Users welcomes this Consultation on Long-Term Financing of the European Economy and we praise the European Commission for focusing on this fundamental economic objective. The promotion of long term investments in Europe has been indeed often overlooked in recent EU financial policy making, as several past and current EU policy initiatives do not encourage long-term behaviour by investors and other stakeholders. The Commission also bravely brings up the issue of the consistency of the regulatory financial reforms vis-à-vis the long term financing of the economy[1].

Long-term savings and investments are a very important issue for individual shareholders and other retail investors and savers. As the European Commission explained in 2007, *"due to the nature of long-term savings and pension plans, particular care is needed to ensure that consumers are being offered products that are really adapted to their needs and marketed appropriately. These are major, once in a lifetime, financial decisions for consumers. Therefore, consumers must be in a position to make their choices in full knowledge of the product, correctly assessing their circumstances and needs"*[2]. We could not agree more with the Commission's diagnosis; however the necessary and effective implementation of these objectives has yet to come.

We ask the European Authorities to focus on the root causes of the inadequate long term financing of the European economy:

- First of all, **rehabilitate investments in equity** - in particular by individual investors - since households are the main source of funds to finance investment (as recognized by the Green Paper), and since they mostly have long term savings goals (housing, education, retirement). Equities are indeed the simplest, most long term and most liquid long term investment products.

- **Stop the destruction of the value of long term and pension savings**[3], for which financial intermediaries and governments are responsible, more so than the actual performance of capital markets.

- Reverse the fragmentation and reintermediation of long term capital markets that has been accelerating under MiFID I and make end investors less dependent on intermediaries.

[1] Green Paper on Retail Financial Services in the Single Market, April 2007, page 11
[2] European Commission: Green paper on retail financial services, 2007.
[3] As evidenced by our research report *"Private Pensions: The Real Returns"* published by EuroFinUse, June 2013

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- Align incentives for investment intermediaries to those of their clients.

- Improve the compliance of institutional investors with their fiduciary duties and formalize rules and supervision for its exercise.

- Simplify and improve rather than increase the complexity and length of the already convoluted and drawn-out list of long term investment products in the EU.

- Adapt and harmonize prudential regulation in order not to penalize investments in equities and other long term assets when they are funding long term liabilities; and whether the institutions involved are insurance-regulated or not.

- Ensure that the taxation of savings in the EU favours long-term savings and investments in the real economy; avoid taxing real long term investment returns at 100% or more; simplify taxes to allow for the calculation of after-tax investment returns, especially for pension products; eliminate the double taxation of cross-border dividends within the EU and the penalization of individual long term investors by the EU Financial Transaction Tax ("FTT") and other similar schemes established at EU Member States level.

We would like to comment in more depth on these and other points and relate them to the questions proposed by the European Commission on its consultation:

I. The definition and characteristics of long-term financing

(Questions 1 and 2)

We would like to make a series of comments as regards to the analysis of the supply and characteristics of long term financing as develop in the LTI Green Paper. This analysis is crucial to the understanding of the root causes of the lack of adequate long term investment in the European Economy. We feel the less than two pages of the Green Paper on this issue are too short and general, and especially the given reasons why households – the main source of funds – are currently leaning towards short term savings.

- **The role of Governments**

Despite the mentioned efforts of governments to promote long-term investment (which they also do themselves) we believe they do not always act consistently with such efforts: in France for example, the only savings product benefiting from total tax exemption is the *Livret A* (an on sight bank savings accounts) which although must –at least partially- support social housing projects, does not favour long-term savings, but – on the contrary – very short term savings. We are surprised that the EC would mention this subsidized short term product as an option to consider. Also, for example, the *Retraite Additionnelle de la Fonction Publique*, a mandatory second-pillar state-controlled pension fund for French public employees with liability duration of about 30 years, invests only 25% maximum in equities. Indeed, FAIDER[4] stated on its White Book on Savings[5] that the current savings level in France is high, however the existing regulatory and fiscal framework is particularly inefficient as regards to canalize the fluxes towards the financing of enterprises and other productive investments.

- **The role of Households**

We do not agree on the fact that short-term savings are the most preferred saving instrument for households. Households have mostly long-term saving needs; if they use short-term investment instruments it is often because they are pushed to do so by intermediaries, by fiscal incentives, and by the poor results of "packaged" long term products.

[4] FAIDER, la Fédération des Associations Indépendantes de Défense des Epargnants pour la Retraite, is a founding member of EuroFinUse

[5] *Le Livret Blanc des Etats Généraux de l'Epargne*, January 2013, page 33.

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The Commission acknowledged this key issue in its Staff Working Document (and regrettably not in the Green Paper itself) rightly pointing out that one of the reasons why households may not invest long-term is the "*often poor performance of financial intermediaries to deliver reasonable returns, and the costs of intermediation*"[6]. But even the Working Document falls short of analysing how poor these returns are and why so. Our just released research[7] does that: Net real (net of inflation and other costs) returns of pension savings have been on average negative over the recent past, and the main reason is the very high amount of fees and commissions charged year after year on "packaged" long term and pension products.

Example: Real case of a Belgian occupational pension fund:

Capital markets vs. Belgian Occupational pension funds 13 year performance (2000 to 2012)	
Capital markets (benchmark index*) performance	
Nominal performance	+48%
Real performance (before tax)	+11%
Fund performance	
Nominal performance	+10%
Real performance (before tax)	- 25%
* 50 % Equity / 50 % bonds (MSCI World equity index and JPM Euro Bond Index)	

One should not expect - and even more so push - EU citizens to continue and to increase their investments in such long term value destroying products. Our Research Report recommends the following policy measures to urgently address this dramatic issue:

- Improve and harmonize disclosures for all long term and retirement savings products;
    - "PRIPs" (EU proposed Regulation for a Key Information Document (KID) for all retail investment products;
    - Disclosure of full costs and long term historical returns must be provided:
        - After inflation;
        - After all charges borne directly or indirectly by the investor; and
        - After taxes (as required in the US for investment funds).

[6] Commission Staff Working Document "Long-Term Financing of the European Economy" accompanying the Green Paper on Long Investment, European Commission, 25 March 2013, page 10
[7] EuroFinUse research report "Private Pensions: The Real Returns", June 2013

- Design simple retirement savings vehicles and securities that protect the long-term purchasing power of savings:
    - Readily accessible, without need for advice and its associated commissions;
    - Promoted by public programs;

- Special treatment by prudential regulation of all pension products (insurance and non-insurance regulated): the long duration of the liabilities allow for higher portfolio allocation on investments such as equities;

- Taxation to incentivize long term retirement savings and investment over consumption and short term savings, or at least not penalise this behaviour;

- Basic financial mathematics part of school curricula, as this is a crucial tool in selecting suitable investment products for pension savers.

One of the conclusions of the Kay Review[8] for the UK equity market also captures another cause that can be extrapolated to all other EU equity markets; *"the principal causes of short-termism in equity markets are the decline of trust and the misalignment of incentives throughout the equity investment chain".* Therefore, we can say individual shareholders and other long term investors are the main victims of these misalignments of incentives, especially as they are at the end of investment chain: this is why special attention should be paid to individual shareholders and other long term investors in order to restore their badly damaged trust in financial markets.

We are aware as well of the steady reduction of equity on households' investment portfolios[9], but the cause is not retail investor preferences but the inducements received by intermediaries when selling packaged products (which they do not receive when selling plain vanilla equities e.g. bonds and shares)[10].

The holding period of investments by retail shareholders is on average much longer than the average holding period of underlying securities by the manager of the "packaged" product –on average, within a year every share will change its ownership in EU-domiciled equity funds. We

[8] The Kay Review of UK equity markets and long-term decision-making, John Kay, July 2012, page 9
[9] We understand this reduction has been experienced in the direct equity holding but, indirectly –through UCITS and other mutual funds- households- they still are the real owners of the economy. This misalignment between the *agent* and the *real* owners, however, may the cause of the alleged short-termism not only of households but also of the rest of stakeholders.
[10] For a more details please check EuroFinUse Position on the Regulation for Packaged Retail Investment Products (PRIPs).

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do not agree either on the fact that households prefer liquidity and easy redemption for retirement savings because, for these products, these factors are not as important as the real (after inflation) long-term returns.

Also, as courageously recognized by some EU Authorities[11], large market abuses have too often not been properly identified and sanctioned in the EU (as compared to the US for example): this is also a significant cause of the lack of confidence of non-insider investors in Europe. The current economic depression, high unemployment rates and banking failures – too often unforeseen by regulators[12] may have promoted more distrust and short-termist preferences of retail investors.

We find the definition of long term financing of the G20 much more appropriate and clearer than other alternative definitions which do not set any maturity threshold, such as "*LTI is a process by which the financial system provides the funding to pay for investments that stretch over a period of time*". We agree with the LTI Green Paper on the fact equities' features make them a perfect candidate to be the standard source for the long-term financing of the real economy: no maturity, and a possibility to influence the long-term performance of the companies which benefit of the funding from the investor. Therefore, we would like to encourage the European Commission to act accordingly and consider equity investment as a master stone of their proposal for the long-term investment strategy of the EU.

II. The Role of Banks in Long-Term Financing

(Question 3)

We share the concerns of the European Commission on the potential crowding-out effect of prudential regulation onto the financing of the real economy in favour of financial institutions. Indeed, we believe the new capital requirements imposed to EU financial institutions through the 4th Capital Requirements Directive could have triggered the well-observed effect in the port-crisis European economy: capital flying black from the real economy -and most remarkably from SMEs- back to banks' balance sheets. The current economic recession just further reinforces this process; and the unprecedented financing facilities from the ECB to European banks –especially the Long-Term Refinancing Operations or LTROs, 3-year loans at 1% interest rate totalling €1 trillion - had virtually no effects on the provision of credit to the real economy. This can be explained by the very simple reason: the only condition required by the ECB for the massive

[11] See for example the current public consultation by the French financial supervisor AMF on its 2013-2016 strategic plan.

[12] See the European Banking Authority stress tests released in July 2011, that publicized the capital adequacy of Dexia (which collapsed a month later) and of the two Cyprus leading banks

LTRO subsidy to banks was to provide Euro Government bonds as collateral! For a more complete overview of our position on CRD IV, please read our Position Paper.

We believe that separating commercial banking from investment banking will have an enormous importance as regards to ensure the financing of the real economy. Moreover, a sustainable financial system is a prerequisite for long-term investment, as banking crises –as we have experienced especially in the last five years– wipe out investors' capital and compromise public finances. The separation of investment and retail banking activities should allow a much lower involvement of public money in banking problems, as only the core commercial banking business (collecting deposits and lending to the real economy) should be refinanced and "saved". Also, the separation of investment and retail banking would reduce the number of *too big to fail* or systemic financial institutions, which is a key measure to enhance systemic stability. Finally, it would be ensured that ECB's credit facilities would be ultimately used to fund the real economy and not to compensate the losses of other non-commercial banking activities such as market trading, investment banking, asset management or insurance.

However, the implementation of this separation is being too much delayed and watered down in Europe: the debate around the Dodd-Frank and the Volker rule started right after the sub-prime crisis in United States, and its implementation is indeed much closer, and recognised as one of the key pieces for economic recovery. On the contrary, diverse EU Member States (France, United Kingdom) have started restructuring their national banking systems according to their own criteria. We believe this way of proceeding is completely counterproductive and be generally negative for the whole EU internal market. At this point, we would like to refer to our Response to the Consultation on the Liikanen Report and to the speech of EuroFinUse´s Managing Director in the European Parliament for more details on our views on the reform of banking structures.

III. The Role of Public development banks

(Questions 4 and 5)

We think that other development banks than those mentioned in the Green Paper such as the European Bank for Reconstruction and Development and the World Bank, should also be engaged with the described EU-wide financial instruments currently managed by the European Commission, the EIB and the EIF. Increasing the coordination between all these bodies seems a good measure to us, especially that such initiatives seem somehow uncoordinated and overall unclear.

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For instance, we have knowledge of two different programmes aimed at strengthening corporate governance in Romania organized by the World Bank on the one side and by the EBRD on the other. We wonder whether these initiatives are in any sense coordinated between both organizations and with the EU ones to increase the potential impact and returns of public spending. Also, we observe that these initiatives too often consist in giving public funds to commercial consultants which in turn ask NGOs such as the member organisations of EuroFinUse to provide evidence and analyses to them for free. Public multinational funding institutions should better ensure they reach out to the user and civil society organisations.

We would also support the increase the transparency of such institutions and especially to strengthen their governance not only to guarantee the correct performance of such long-term objectives but also to facilitate the understanding and engagement by other stakeholders in such long-term initiatives.

IV. The Role of Equities in Long-Term Financing

(Question 12)

In our view, the easiest and most efficient way to promote long term investment has not been sufficiently considered by the European Commission: the promotion of the direct holding of assets by end investors, and especially by retail investors. Retail investors have long-term investing needs (housing, higher education, elderly care) and therefore they are aligned with such long-term financing needs of the economy. When investing in packaged products, they lose the direct control of their assets (which is especially cumbersome in the case of shares, as -nor them neither the companies themselves- benefit of the engagement of the real owners thorough the exercise of voting and other participation rights). Such an agency relation, especially when maintained long-term and with engaged investors, is likely to create a continuous and constructive dialogue between the source and destination of capital, which is likely to generate benefits for both of the parties.

We are aware of the fact that, as FAIDER stated on its White Book on Savings[13], that there is a substantial risk when investing in shares and bonds, and that investing long-term in these instruments represents a supplementary risk. However, the current initiatives aimed at strengthening corporate governance practices in the European Union - such as the Green Paper on Corporate Governance and the Reform of the Audit Markets (our related position papers here and here), will in our opinion contribute to reduce such long-term risks of shares and

[13] *Le Livret Blanc des Etats Generaux de l'Epargne*, FAIDER, January 2013, page 37

bonds. On the other side, one of the other advantages of investing in shares and bonds is that the liquidity problems of long-term investment would be tackled[14].

In order to gain a good overview on this issue as well as to design concrete policy proposals, the European Commission could tender a study, following the research project from the European Commission's FSUG (Financial Services Users Group[15]) to identify more precisely the evolution of the ownership structure of EU listed companies in the last decades to know exactly how many of listed companies' shares are still in the hands of retail investors.

We also agree with the concerns as expressed in the McKinsey Report *The emerging equity*[16] on the gloomy outlook for issuers to place their shares and bonds; and we would like to add that this *equity gap* and related fragmentation issues will be more acute for *big cap* issuers. We believe the inclusion of plain vanilla equity into the PRIPS Regulation would definitely make a positive impact at revitalising capital markets and enable to resume the communication and promotion of equities by intermediaries to EU citizens. The Kay report[17] again, analyses very correctly the relationship between investors and companies through the investment chain: *"Financial intermediation depends on trust and confidence (…) trust and confidence are the product of long-term commercial and personal relationships: trust and confidence are not generally created by trading between anonymous agents attempting to make short term gains at each other's expense. Trust and confidence, or their absence, are the product of the prevailing culture (…) We must create cultures in which business and finance can work together to create high performing companies and earn returns for savers on a sustainable basis"*.

We would just like to finally refer to - as we agree word by word with it - the statement of the European Commission: "*Market intermediaries often benefit themselves more than the end-user"*[18]. We agree with the aforementioned Working Paper proposals for strengthening and improving funds' allocation into productive long term investment by tackling misalignments in financial intermediation[19].

[14] *Le Livret Blanc des Etats Generaux de l'Epargne*, FAIDER, January 2013, page 37
[15] http://ec.europa.eu/internal_market/finservices-retail/fsug/index_en.htm
[16] *"The Emerging Equity Gap. Growth and Stability in the new investor landscape"*, December 2011, McKinsey Global Institute
[17] The Kay Review of UK equity markets and long-term decision-making, John Kay, July 2012, page 5
[18] Commission Staff Working Document "Long-Term Financing of the European Economy" accompanying the Green Paper on Long Investment, European Commission, pages 10 - 11
[19] Ibid, page 3

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V. *The diminishing role of Institutional Investors*

(Question 6)

As EuroFinUse stated on its Position Paper on the Green Paper on Corporate Governance[20], we believe that the engagement of institutional investors could be strengthened by compulsory measures aimed at increasing transparency through the full disclosure of their voting policy and the exercise of such voting rights. Also, it could be considered to extend the obligation to exercise such voting rights for institutional shareholders.

EuroFinUse report *"Private Pensions: The Real Return"* acknowledges the fact that prudential regulation should recognise the very long investment horizons that pension vehicles potentially have, whatever the legal framework they belong to: insurance-ruled or not.

The introduction of Solvency II discourages equity ownership by insurance companies. This discrimination against equity ownership will reduce the real return capability of private pensions. It may also have adverse secondary effects on the pricing and supply of risk capital in Europe. Our case rests on the observation that pension savers are in most cases legally prohibited from calling on their pension resources until retirement. Consequently short term market volatility is of little concern for a liability that is due several years or even decades in the future. Therefore, severe regulatory restrictions placed on equity assets will only reduce the opportunity for pension savers to earn real returns on their investments. Further, in periods of crisis these assets can offer exceptional returns to a pension vehicle with a long investment horizon, precisely because other investment vehicles with shorter investment horizons cannot bear the same risk.

We are concerned that the direction of regulation masks an underlying interest on the part of governments to force savers to buy government debt in order to reduce the cost of financing that debt – this is financial repression. Effectively enforced ownership of government debt means that pension savers will have to purchase overpriced government securities – sometimes with interest rates below the level of inflation – that will reduce their opportunity to earn a real return. The experience of the holders of French and Spanish government debt from the 1950s to the 1970s vividly shows how governments are willing to inflate away the real value of their debt at the expense of the saver's interest. This is unacceptable, particularly at a time when governments are calling on their citizens to take a greater responsibility for their own retirement.

[20] Page 8.

Hence, we vigorously oppose any regulatory measures that discriminate against equity ownership in the pensions sector and we urge policy makers to consider a regulatory framework for the pensions sector that is common to all providers whether they are insurance regulated or not. This is why we regret that the upcoming revision of the IORP directive avoids the critical solvency issue.

We would also like to refer to the fact that institutional investors are sometimes barred from making long term investments into the real economy: as mentioned earlier, the RAFP public pension fund, for example, has a legal limit of 25% of capital to be invested in equities.

We note as well that the Commission is referring to their diverse consultations on the creation of a specific regulatory framework for the development of Long Term Investment Funds (LTIF). We have previously referred to this issue in our Response to the Questionnaire from the Asset Management Unit from DG Internal Market and our Response to the Consultation on UCITS and Long Term Investment.

Individual investors and savers are already faced with much too numerous types of long term investment products. For example in France, no less than fourteen different types of long term funds are offered to retail investors, not mentioning the other long term investment products proposed by banks and by insurers[21]. This is already creating too much complexity and confusion in the retail investment markets. Therefore, we believe European Authorities would be better inspired to improve and simplify the exiting offerings of long term investment products rather than create yet another category of long term product.

At the same time, MiFID has further marginalized individual investors' share of equity markets, by increasing sharply the information asymmetry in favour of financial market participants, reducing the transparency of trade information, while failing to decrease transaction costs for retail investors. Also, European national governments have an objective interest to favour fixed income versus equity investments by institutional investors because of the huge amounts of public debt being issued currently. The Commission should take this into account.

Finally, EuroFinUse does not agree with the rejection of prudence by the IFRS in favour of more "neutral" approaches, which would be more consistent with such "fair value" or market-based valuation of assets. As we state in our Position Paper on the IFRS, European accounting

[21] UCITs, general purpose funds which are not UCITs, "SICAF" (fixed capital investment funds), FCPE, and SICAVAS (for corporate savings and pension DC plans), FCPI (funds for innovation), FIP (for local most often unlisted investments), SCPI and OPCI (for property investments) and many more. Banks propose already "PEA" (equity plans) and insurers a lot of long term products as well.

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standards maintained the prudent approach for accounting, but that poses a problem of comparability with IFRS for which we are extremely concerned. We defend a global, not only European, shift for prudent accounting to preserve investors' value.

VI. Other options to promote long-term investment

(Questions 13, 14, 15, 24 and 25)

We would like to comment on some of the specific proposals or ideas developed by the Commission to boost long-term investment:

-Covered bonds can play a role as regards to the avoiding the excessive risk-taking behaviour that has characterised the financial industry of the last decades.

> At this point, we would like to refer to our recommendation from EuroFinUse's Response to the Consultation on the Liikanen Report to require banks to keep at least the 50 % of the counterparty risk when securitizing their loans.
>
> We believe that if - especially in the case of United States and to a certain extent in Europe too- if subprime loans had stayed in the lending banks' balance sheets as it was the case in the past prior to the massive securitization wave of the 1990s and 2000s, banks would have exercised much more scrutiny and would have been much more responsible lenders. Therefore, banks could make use of covered bonds in order to keep the overall percentage of counterparty risk on the balance sheet under the required threshold (our proposal would be of 50% minimum).

- We believe in the need for a new framework for securitization. The lack of control of securitization processes contributed to a big extent to the propagation of the excessive risks taken by the financial industry to the overall economy; therefore it is absolutely necessary that regulators and supervisors look carefully at these processes in order to establish a new, sufficient and appropriate regulatory framework to tackle such issues. The requirement for banks to keep at least the 50% of the counterparty risk when securitizing their loans should be the starting point for this objective.

- As regards to the creation of an EU-wide savings account instrument, we are not favourable to this; especially because of the costs that such schemes are likely to generate to the taxpayer and because we doubt is the most appropriate mechanism to channel retail savings into long term investment. We believe that savings accounts – as they are sight deposits, e.g., funds can be immediately withdrawn - are short-term instruments and therefore they are not adequate to channel funds to long-term investment.

Despite the fact they may seem very favourable for the retail investor, there are better ways to improve the state-of-art for retail investors, and that can at the same time efficiently channel funds to long-term investments. The European Commission Green Paper on Retail Financial Services from 2007 stated that retail investors have to be offered products which are adapted to their needs and that are marketed appropriately: not much has been done since that date; and it seems in view of the current negotiations for MiFID II, IMD 2 and PRIPs that we are very unfortunately still not coming any closer to that objective.

In any case, we agree on the need to pay special attention to the difficulties for retail investors to find suitable investment products that allow them to achieve positive returns for their savings at least to maintaining the real value of their savings, which is a phenomenon described as "*financial repression*". Other examples of publicly-promoted (and sometimes managed) products are the ATP scheme from Denmark[22] and the Australian mandatory personal savings plan, which provides guaranteed minimum returns over inflation to savers.

- As regards to the creation of specific long term benchmarks, we stated in our response to the joint EBA – ESMA Consultation on Principles for Benchmarks-Setting Processes in the EU, that we are concerned by the problem not only of the continuity of the index itself, but also at the benchmarked product level, which are obviously more acute when the longer the periods of time are considered. For the rest, we believe that products using these longer-term benchmarks must also have a long tracking record, in order to avoid possible incongruences otherwise.

- Finally, we have welcomed the European Commission's proposals on Non-Financial Reporting as we feel the integration of financial and non-financial information has been traditionally overlooked (and insufficiently considered jointly with soft-law approaches in the framework of Corporate Social Responsibility) although, to date, it is the almost only way for investors to obtain needed information to forecast the long-term potential performance of companies and effectively comply with some of their fiduciary duties (e.g. compliance of companies with social responsibility standards).

VII. Tax treatment of Long-Term Investment

[22]Danish citizens receiving a salary or welfare benefits The ATP scheme are obliged to contribute to the ATP scheme; self-employed can contribute on a voluntary basis to the scheme. EuroFinUse analyses this scheme on its Report "Private Pensions: The Real Return" which is due by June 2013

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(Questions 18 and 19)

EuroFinUse praises the EC to point out this fundamental issue, although taxation is the primary responsibility of Member States. Our member FAIDER's White Book on Savings refers to basic principles that national tax systems should respect[23]:

- National tax systems should favour growth; much more balanced risk-taking approaches, as they often draw savings away from real economy funding and promote sovereign debt investing; and long term investment horizons through digressive fiscal charges (which should be lower the more risky the investment is and the longer the investment horizon is).

- A simple, understandable and stable taxation.

- A taxation favouring investment in SMEs taking into account the riskiness, the often low level of returns and lack of liquidity of these investments; which are some reasons to explain the often low funding levels of such investments.

It is also necessary to enhance the coordination of Member States and promote a coherent, pan-European framework to promote more long-termist behaviour of investors.

The current EU "FTT" initiative is grossly inconsistent with the goal to improve long term investment in Europe: favouring again short term and packaged products, exempting the biggest financial market of all (foreign exchange spot markets) and seriously discriminating again[24] individual direct equity investors versus pension funds, government bond traders, derivatives traders, and professional traders more generally who can much more easily use trading venues that will not be subject to such a tax.

Last but not least important, it is very necessary to tackle the – unfortunately on-going - problems of double taxation of dividends when distributed cross-border (see EuroFinUse's response to the related Consultation of the European Commission).

VIII. How to incentivize long-term investment amongst stakeholders

(Questions 21, 22 and 23)

[23] *Le Livret Blanc des Etats Généraux de l'Epargne*, January 2013, page 39

[24] Like existing Member State level FTTs such as the Belgian *Taxe sur les opérations de bourse,* and the UK's *stamp duty*; mostly paid by retail equity investors.

We acknowledge the disengagement of most shareholders nowadays, which was identified in John Kay's Review of equity markets in the United Kingdom[25]. EuroFinUse analysed in-depth the problems experienced by individual shareholders to engage long-term - even to engage at all or to exercise the rights they are entitled with as shareholders - on its *Barriers to Shareholders Engagement* report. Our Position Paper on the Green Paper on Corporate Governance provides concrete proposals to tackle these short-termist attitudes of a certain part of the shareholders – which in our view is not compatible with a proper exercise of their fiduciary duty - which we believe are not generalised but rather typical of a certain type within the spectrum of shareholders that typically have EU companies.

As regards to asset management, EuroFinUse understands that remuneration incentives are one of the most important factors influencing asset managers' behaviour, as we stated in the debate for fund managers' remuneration structures in the discussions around UCITS V proposal. In general, asset managers' remuneration on long term products should not be based on short-term performance but rather be referenced to the long-term investment real returns of their portfolios.

We believe a clear and precise definition of the "fiduciary duty" concept is an important point to address, not only for asset managers and custodians, but especially by the distributors of financial products to retail clients. We believe intermediaries and sellers' fiduciary duties have a capital importance, as any misalignments of interests with their clients will result in immediate - and often serious - damages. In this regard, for retail investment products the issue is not so much re-defining fiduciary duties (either at long-term or on its wider meaning) but rather implementing them. We are extremely concerned by the non-implementation of the provisions to act in the best interest of the client in MiFID 2006 Directive articles 26 and 27[26], and also considering the European Parliament's proposals to water down this principle in IMD2 and MiFID II).

IX. Proposals for SME financing

(Questions 26 and 28)

As stated by the ESMA Securities and Markets Stakeholder Group report on *"Helping Small and Medium Sized Companies Access Funding"*, the cost of access to financial markets by SMEs has been multiplied since the introduction of MiFID due to the proliferation of non-transparent,

[25] The Kay Review of UK equity markets and long-term decision-making, John Kay, July 2012, page 9

[26] Article 26 on inducements and article 27 on « fair, exact and not misleading information ». for example, a recent survey by the French supervisor found that two third of intermediaries who responded confessed they did not comply with article 26.

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unregulated market venues from which only a very limited range of stakeholders benefit of. EuroFinUse criticised in our Position Paper on the Proposals in MiFID II on capital market structures the fact that retail investors and other financial services users are *de facto* excluded from any benefits arising from MiFID I as well. That is why we proposed the provision of consolidated tape to retail investors free of charge by the brokers. Had SMEs to pay for consolidated tape in every one of the EU MS, it could be quite a considerable cost, and another added problem to the current financial markets fragmentation experienced in the European Union.

The implementation of the Solvency II Directive as well as the Capital Requirement Directive (CRD IV), as explained before, will only further crowded-out SMEs from the investable capital for private equity and venture capital funds.

Alternative stock markets could be a valuable instrument for SME financing because equity rather than debt is the preferred source of long-term funding for SMEs. Only equity can provide high-risk capital and the more that businesses are "knowledge-based" rather than based on physical assets, the more important this becomes because the lack of assets prejudices conventional debt security. In most EU Member States, SME market in terms of equity funding is dominated by private equity – from business angels and "friends and family" at the lower end, to VCTs (Venture Capital Trusts) and other corporate investors at the higher end. Of course, some of these vehicles are listed themselves; but they tend to have an aversion to risk, and a fairly short term time horizon, i.e. they are often not long-term investors and frequently averse to investing in technology companies.

EuroFinUse's member ShareSoc however considers the publicly quoted equity markets in the UK (primarily AIM now; with other alternative venues never having in fact reached a viable size), are not succeeding in essence, due to certain reasons:

- The number of companies listed, and listing, on the AIM has been falling since 2007 and continues to do so[27], and most of the new listings are from non-UK companies. We should also take especial consideration of costs issues: few SMEs –only the biggest size segment- would justify the cost of listing on AIM, and the on-going cost of maintaining the listing and covering all the other required costs of being a public company.

- The timescales to raise funding by such listings is uncertain and the outcome unsure: meanwhile, a private equity investor can often move rapidly and offer business network support in addition (in other words they are usually "hands-on" investors even though

[27] As stated by the Quoted Companies Alliance

this has both positive and negative aspects for the recipients of such investment, with often onerous investment agreements).

This is why, according to ShareSoc's experience, directors or existing investors (who may often be previous private equity investors) are hardly likely to favour a listing on AIM, when they perceive the benefits are so low. Although a public listing may provide a free market in the shares, in reality the major holders will be unlikely to be able to take advantage of it because of the low liquidity in AIM shares and the need to make commitments regarding share sales as part of the listing. In addition the initial and on-going management effort will be much more considerable. For example, there will be lots more people to talk to than is the case with one or two private equity investors. Regulation will also be a considerable burden and is exceedingly complex in comparison with simply adhering to Company Law and the terms of any investment agreement.

Even the price achievable on AIM after the initial listing, which impacts on further fund raisings, may not be a reasonable and give a consistent valuation because of the variable nature of AIM stock prices arising from low liquidity, the poor research, the emotion driven market sentiment and for other reasons.

The general reputation of AIM and the past experience of companies listed upon it also does not encourage companies to consider listing thereon. So you can see that the attractiveness of an AIM or other market listing for UK SMEs is very low.

The main disadvantage for financing via private equity is that funding from such sources is limited and the focus of such companies is also often limited in scope. Private equity often prefers to invest in already established and profitable companies with significant assets, and will avoid start-ups, technology companies and sometimes whole sectors of the market. In addition retail investors do not have easy access to these investment channels (VCTs are one exception but have not in reality, in most cases, produced a decent return for investors). To summarise, there is a big opportunity being missed to provide long-term finance via public equity to SMEs.

Finally, we would like to refer to certain investor protection issues to address: for instance, in United Kingdom most retail investors can purchase any quantity of existing AIM listed shares on an execution-only basis in the market (i.e. without any advice) but cannot take part in new IPOs or placements because they are considered "incompetent" to judge the risks associated with such investments. Even when there are regulations in place to protect the investor in AIM companies (for example, the AIM listing rules), the enforcement of these rules is weak because AIM is a self-regulated market in essence which relies on Nomads (Nominated Advisers,

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approved by LSE) to a large extent. Corporate governance of AIM companies is also very questionable (only a proportion even subscribe to the Quoted Companies Alliance recommendations), and the directors can pay themselves pretty well what they want. Non-executive directors are frequently not independent.

In conclusion, UK's AIM would require significant reform and restructuring to provide a viable base for a healthy public market in SME company shares in United Kingdom. Likewise EU and national legislation related to such companies (for example, the Prospectus Directive) needs substantial reform if it is to be more appropriate to the needs of SME companies and investors in them.

As stated above, SMEs should be granted access to capital markets by establishing a differentiated regime of listing requirements different to those for blue chips. We also believe that the key to stimulating the development of such markets (i.e. encouraging new organisations to create them), is to develop the regulatory framework first because the existing frameworks effectively inhibit them.

Certain options such as *crowdfunding* prove more adequate for SME financing than for big companies, therefore we could speak in this case of a specific emerging "market" for SME financing. EuroFinUse stated there are big opportunities, but also risks to tackle and that such a framework should be first of all effectively regulated and supervised by European authorities in its related Position Paper.