The Association of Corporate Treasurers

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Comments in response to

Green Paper: Building a Capital Markets Union

European Commission,

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The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. It is established by Royal Charter in the public interest. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details and a link to our approach regarding policy submissions can also be found at the back of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter. CMU is potentially an important benefit to funding for non-financial companies (NFCs). It can provide more NFCs with greater access to alternative sources of debt funding to bank loans and perhaps also greater access to equity funding. We are great supporters of the concept.

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree.

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree.

We add the following observations.

The availability of credit information for firms is of potential value to others other than lenders and investors. Credit-type information is important to (potential) suppliers and customers, employees, joint-venturers, etc. of the firm. That *public* information of this kind is available is important to a flourishing eco-system in which they firms can live, adapt, and, in appropriate cases, grow is important. Its restriction, even on payment of a modest fee, to particular, usually financial services, firms is unhelpful.

The majority of SMEs are unincorporated businesses. Capital markets as such are not relevant to these.

SME companies with relatively predictable revenue earning capacity or transferable assets of use to others may be suitable for some debt financing (including asset-based financing). But small firms in general are individually high risk as their ability to absorb external shocks or cope with changed circumstances of key individuals is limited. Equity financing is important to such firms. External debt or equity providers have to be able to look beyond accounting data. They need to be able to hear about, consider, understand and respond (sympathetically but not foolishly) to changing circumstances. Merely publishing credit information will only be a small step.

But, especially for high-risk, potentially high-growth, (unlisted) companies starting or developing in high-tech or biotech sectors, the value of the firm is not in identifiable assets but in the real options to develop, exploit, defer or abandon and these require all (or mostly all) equity finance. For these, credit information in the form of historical accounts is of little value. Such firms will have the worst of credit scores or need a special “speculative” categorisation in any credit scoring process. Such firms will look to sources of equity financing.

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

Take up we suspect is here intended as take up by investment managers promoting suitable funds. Naturally, the detailed final rules are key here and doubtless prospective fund promoters will comment.

We would see LTIFs as potential providers of funds to companies. If this is as debt finance we think it important that this can be as loans as well as transferable securities. Loan investment can be restricted at Member State level and that may require addressing. (As a side comment on

loans, most companies will properly wish to restrict the transferability of loans, for tax, risk management and relationship reasons, the ability of the lender satisfactorily to manage the relationship being especially important for these smaller companies. Similar considerations will apply to relationship aspects of debt securities issued by smaller companies. Such restrictions of course reduce liquidity of the underlying loan or note.)

Looking narrowly at the potential for equity investment in companies, prospective investee firms will have to take account of the expected fund lives. If the fund is taking unlisted equity in a relatively small firm, the firm will need to factor in that the prospective ELTIF investor may be agitating for a liquidity event (sale, listing, etc.) at times related to the fund life issues rather than to the needs and suitability of the underlying business. We were pleased to see the softening of the 10-year horizon originally mooted, but care needs to be taken in the final rules to avoid further restricting genuine long-term funds (as traditional UK investment trusts with unlimited life are). Unlimited life ELTIFs lend themselves to listing, of course, like traditional UK investment trusts. Listing and the associated transparency and governance requirements providing both liquidity and some reassurance to (often retail) investors.

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

Yes

No ✓

Comments on question 4:

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree.

There is one step that could be taken at the EU level, however. That is that we think that refinement of the categorisation of risk "buckets" in Solvency II etc. could usefully be refined to recognise that the risks to which "buy and hold" investors – of the kind to what private placements are aimed – are different from those to shorter-term holders and to traders of corporate debt. For example, "market to market" and liquidity issues are less important. Of course private placements, while transferable, are never intended to have a recognisably liquid secondary market.

More fundamentally, we think the biggest barrier to issue is the need to educate not only potential investors but, and especially, issuers. And within issuers, this applies to finance staff but also chief executives and boards including non-executive directors as many will only have been familiar with banks as lenders and loans as the medium. This will take time, in many cases, some years. The Guide published by the Pan European Private Placement Working Group coordinated by the International Capital Markets Association is an important step in facilitating communication with potential issuers.

We have been very pleased at the issue of model documentation sets by the Loan Market Association and the Euro PP Working Group that are available for customisation for use by issuers according to their own circumstances. We think it important that (relative and flexible) standardisation develop as a matter of market practice and not be prescribed or imposed, especially given what we expect to be slow development of issuing into this market.

Some similar considerations on the availability of credit information to those discussed in our comments on SME credit data (Question 2) apply to mid-sized companies that may look to use private placement markets. Here, though, we have been pleased to note that some External Credit Assessment Institutions/rating agencies have started to offer credit categorisation of mid market companies (and what have become known in the UK as mid+ companies with a turnover of up to 1 bn) of the kind that may fund through European private placements.

Measures to develop and integrate capital markets - Improving access to finance

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree.

We think it important that capital markets be seen as supplementing and complementing (not displacing) the current, mainly bank, sources of finance to SMEs and mid sized companies (including what in the UK have become known in the UK as mid+ companies with turnovers up to £1 bn).

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree. The EACT's comments are very important.

We would add the comment that listed companies are already constrained in the timing of access to capital markets due to restrictions surrounding routine reporting times and also periods when the company has (properly) unannounced price sensitive information. Further restriction on the issue and maturity (the two are linked) of debt would be most unhelpful.

And standardisation of terms and conditions is not possible given the number of issuers and their individual contingencies.

Secondary market liquidity must be expected to be low, especially where obligors reasonably need to restrict transferability. Lack of liquidity is in some respects not a defect but an attribute. But in some respects it certainly is a needless defect. For example the different tax and insolvency regimes between member states certainly diminish investor pools willing to invest cross border and so, potentially, liquidity. While changes in these aspects may be difficult and take many years to address, the benefits may be material. It goes without saying that standardisation on inappropriate practices would not be helpful.

Corporate issuers will adapt issues (within reason) to investor demands – reflected in pricing and demand on issue. Some investors say that standardisation would improve secondary market liquidity. But evidence for that is small. Asking investors if they would recognise liquidity-enhancing features in a bond in the pricing of it on issue gets a negative answer or just evasion. There was equally no recognition of it prior to the financial crisis of 2007/8. Liquidity enhanced corporate bonds would likely be a very niche market if there were a market at all.

We recognise that there may be financial stability implications of illiquidity in secondary bond markets if, for example, in time of crisis, many investors, even those intending to have been

long-term holders or hold-to-maturity investors, are obliged to reduce the size of their balance sheets at the same time. Incremental steps to standardisation – some of the mechanics of issuance and documentation and the tax and insolvency points mentioned above will help, of course. But actions by the Reserve Bank of Australia and, notably, the Bank of England in corporate bonds and commercial paper show how this can be handled in extremis. The Bank of England's press release of Paul Fisher's speech on, *The Corporate Sector and the Bank of England's Asset Purchases*, to the Association of Corporate Treasurers in 2010 says the asset purchase facility introduced in the financial crisis of 2007/8 "helped to reduce the liquidity premium in that market by improving the process of price discovery and offering a 'back stop' bid in the secondary market." and "These operations have been consistent with a central bank's 'Market Maker of Last Resort' function". The full speech is available at http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech423.pdf, accompanying charts http://www.bankofengland.co.uk/archive/Documents/historicpubs/speeches/2010/speech423charts.pdf

7. Is any action by the EU needed to facilitate the development of standardised, transparent and accountable ESG (Environment, Social and Governance) investment, including green bonds, other than supporting the development of guidelines by the market?

Yes

No ✓

Comments on question 7:

Our comments and those of the European Association of Corporate Treasurers on standardisation of bonds, in response to question 3 and 6 and elsewhere are both very pertinent here.

8. Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree. The EACT's comments are very important.

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree. The EACT's comments are very important.

Measures to develop and integrate capital markets - Developing and diversifying the supply of funding - Boosting institutional investment

10. What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

Again, we stress the importance of suitably calibrated risk "buckets" for regulated investors.

And again we draw attention to our comments (and those of the European Association of Corporate Treasurers) in response to Question 6 on standardisation of bonds.

11. What steps could be taken to reduce the costs to fund managers of setting up and marketing funds across the EU? What barriers are there to funds benefiting from economies of scale?

12. Should work on the tailored treatment of infrastructure investments target certain clearly identifiable sub-classes of assets?

Comments on question 12:

Again, here appropriate calibration of risk "buckets" for regulated investors is important. This needs to recognise the higher risk of infrastructure investment during the construction and commission phases but the generally low risk nature of operating phases where relevant, while not overlooking the "catastrophe risk" of trapped infrastructure e.g. water, gas or electricity supply or transport infrastructure supporting a project (a mine, an industrial estate, a port development, etc.) that fails.

12.1 If so, which of these should the Commission prioritise in future reviews of the prudential rules such as CRDIV/CRR and Solvency II?

13. Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

Pension funding arrangements across Member States is very part dependent and has strong legacy effects – it takes a couple of generations fairly to change but nothing will change unless a start is made. But, pensioners and workers that will be future pensioners are for a long time natural long-term investors. If the state pre-empts that investment through state pension schemes (above safety-net levels), other sources of long-term investment are required – perhaps the state directly or through state owned corporations or sovereign investment funds. These questions are above our pay-grade. But we can observe that pan-European availability of long-term, pension oriented, investment opportunities accessible to all citizens would provide a great boost to a European capital market.

14. Would changes to the EuVECA and EuSEF Regulations make it easier for larger EU fund managers to run these types of funds?

14.1 What other changes if any should be made to increase the number of these types of fund?

15. How can the EU further develop private equity and venture capital as an alternative source of finance for the economy?

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree. The EACT's comments are very important.

15.1 In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

We note that many of the transformational inventions of the second half of the twentieth century came of out very long-term investments by firms (e.g. IBM) that had no intention of exiting. The decline of investment including in intellectual property seen in recent decades can perhaps be partly attributed to growing industrial investment by essentially relatively short-term (perhaps better "medium term") investors such as venture capital funds (and private equity).

Encouragement of really long-term investment by existing companies and by investors may yield better results. Traditionally the tax system is used to encourage behaviour the state wishes to promote and here reduced income and capital gains taxation on really long-term investments might be part of the answer.

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

The desire to deduce the size of bank balance sheets is an obstacle for many banks. Encouragement of more large-banks of regional but perhaps not global significance would both add capacity and diversify funding sources (though with the banking sector) for firms.

As noted in response to other questions, the failure of some regulatory risk "bucket" classifications for banks and non-banks to recognise some risk characteristic of corporate lending or lending to particular categories of industrial and commercial firms is a barrier to lending to some firms and some sectors.

Measures to develop and integrate capital markets - Developing and diversifying the supply of funding - Boosting retail investment

17. How can cross border retail participation in UCITS be increased?

18. How can the ESAs further contribute to ensuring consumer and investor protection?

19. What policy measures could increase retail investment?

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree.

We draw attention to the EACT's comments on the mooted financial transaction tax in response to question 21.

19.1 What else could be done to empower and protect EU citizens accessing capital markets?

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

Measures to develop and integrate capital markets - Attracting international investment

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree. The EACT's comments are very important.

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree. The EACT's comments are very important.

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

Comments on question 23:

We are familiar with the submission from the European Association of Corporate treasurers, with which we agree.

We note that greater issuance of registered rather than unregistered bonds has taken place in light of the US FATCA requirements, so that may be a hopeful sign.

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

25. Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a Capital Markets Union?

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree.

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree. We draw attention to an additional aspect.

We would add that in so far as loans to industrial and financial companies or debt securities issued by them, many issuers properly would wish to restrict transferability of the loan or security - see comments in response to question 3 and 6 and others – and that this restricts the use of the obligations as collateral.

It may be that some debt issuers, particularly large firms that have achieved the most favourable terms and conditions such as they may achieve in public bond markets, may be comfortable with limited or no transfer restrictions and they may eventually gain small reductions in interest premia by doing that. But there can be no presumption that the vast majority of firms would find that acceptable.

We are aware that some investment managers have advocated mandatory over-riding of transfer restrictions but this is a blatant case of the financial services industry knowingly and wilfully ignoring the fundamental interests of real economy firms.

To the extent that collateral here refers to assets used in securitisations, where there are transferability issues synthetic securitisation is available as for other obstacles to actual transfer.

27. What measures could be taken to improve the cross-border flow of collateral?

27.1 Should work be undertaken to improve the legal enforceability of collateral and close-out netting arrangements cross-border?

28. What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?

29. What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree.

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

We are familiar with the submission from the European Association of Corporate Treasurers, with which we agree.

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

We are familiar with the lengthy submission from the European Association of Corporate Treasurers, in response to this question, with which we agree.

The Association of Corporate Treasurers

The Association of Corporate Treasurers (ACT) is the leading professional body for international treasury, operating in the public interest under Royal Charter. We provide the widest scope of benchmark qualifications for those working in treasury, risk and corporate finance. Membership is by examination. We define standards, promote best practice and support continuing professional development. We are the professional voice of corporate treasury, representing our members.

Our 4,500 members work widely in companies of all sizes through industry, commerce and professional service firms.

For further information visit www.treasurers.org

Guidelines about our approach to policy and technical matters are available at http://www.treasurers.org/technical/manifesto.

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