association of the luxembourg fund industry

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EUROPEAN COMMISSION
Directorate General Internal
Market and Services
To: markt-lti-funds@ec.europa.eu

Luxembourg, 26.06.2013

RE: ALFI draft response to the questions outlined in the EU Commission green paper on long-term financing of the European economy ("Green Paper")

Dear Sirs,

ALFI, the Association of the Luxembourg Fund Industry is the representative body of the 2.6 trillion Euro Luxembourg fund industry, as at 30 April 2013. It counts among its members not only investment funds but also a large variety of service providers of the financial sector. There are a total of 3,871 undertakings for collective investment in Luxembourg, of which 2,492 are multiple compartment structures containing 12,175 compartments. With the 1,379 single compartment UCIs, there are a total of 13,554 active compartments or sub-funds based in Luxembourg.

I. Past Reflections

Further to our response to your informal questionnaire on long-term investment funds, which aimed to gather further information on the essential characteristics of 'long-term investments' as well as our response to the public UCITS consultation paper published July 2012 (generally referred to as "UCITS VI consultation"), which raised, among others, questions targeted at long-term investments.

We would like to remind you of our response to the UCITS VI consultation that ALFI is very favourable to opening-up long-term investments to a broader range of investors. We consider that this can be beneficial to investors, thus being in a position to diversify their portfolio by having access to more illiquid (long-term) assets, which typically are able to provide stable and potentially higher returns than transferable securities. In addition, it appears to us that opening up such long-term investments (such as infrastructure assets) to new investor groups could also prove to be beneficial to the wider economy in a situation where government budgets are limited, public investments are becoming increasingly rare and where banks are more and more restricted in their financing abilities. In summary, we believe that if embedded into a sound legal framework this could be a situation to benefit all parties concerned.

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We would also like to highlight the two scenarios, which we referred to in our response to the informal questionnaire. In the introductory section of your questionnaire under the heading "Background", reference is made to both large and mid-range institutional investors (hereafter "Institutional Investors") as well as individual investors (hereafter referred to as "Retail Investors"). The UCITS VI consultation targeted specifically the retail investor category.

We make reference to our response to your informal questionnaire and would like to highlight that both large and mid-range institutional investors ("Institutional Investors") as well as individual investors ("Retail Investors") should be considered separately. Institutional Investors throughout Europe will already be able to gain access to a broad range of long-term investment funds ("LTIF") with the implementation of the AIFMD in the different Member States. As the AIFMD provides for a pan-European marketing passport (obviously subject to the applicable conditions being fulfilled), we have the impression that most LTIF such as real estate funds, private equity, infrastructure funds and similar funds could already be accessed by Institutional Investors owing to the implementation of the AIFMD.

This is not the case for Retail Investors, as the AIFMD grants a marketing passport only for the distribution to 'professional clients'. Individual clients (Retail Investors) are generally not covered by such marketing passport and it depends on each EU Member State's decision whether it allows an AIF to be distributed to Retail Investors.

ALFI would support the Commission should it opt forthe creation of a specific LTIF regime for Retail Investors, which would *per se* also be suitable for Institutional Investors.

We are of the opinion that there are different means to achieve such objective. As stated in our response to the UCITS VI consultation, it is our view that the UCITS regime (being a framework for investments in transferable securities with high liquidity) may not be the appropriate framework. The inclusion of LTIF would fundamentally change the features of the UCITS framework, which, in view of its global recognition, could possibly negatively impact the UCITS label as a whole.

We believe that these two options should be considered and analysed.

On the one hand the creation of a parallel framework to the UCITS regime, this could specifically deal with a LTIF product aimed at Retail Investors. In this respect we would like to make reference to our response to the UCITS VI consultation in respect of the features we believe such framework should contain.

On the other hand, we see another possibility in extending the AIFMD to Retail Investors. This idea could be realised by creating an "AIFMD sub-regime", which would contain specific features designed for the purposes of and in view of the needs of the Retail Investor. We think that the latter proposal could potentially be easier to achieve, since it would be possible to leverage on the work undertaken for the AIFMD, where a number of standards have already been implemented that would most probably also apply to LTIFs. For retail investors in illiquid assets the best format is probably a closed-ended fund where the fund liquidity is achieved in the secondary market. This can be achieved through the AIFMD.

II. General Remarks

In response to the detailed concerns set out in your Green Paper, it is apparent that there will be a need in the European Union for long-term investments not only to finance infrastructure, innovation, education and environmental projects, but also to increase competitiveness, support public debt sustainability while providing an alternative long-term savings option for investors. However, we have to bear in mind that with public pensions' funding unlikely to remain sustainable in the "long-term", it may be argued that alternatives to this system will emerge in the coming years and may well partially come from initiatives such as long-term investments financing. The challenges that these public pensions will be facing, although very different, are likely to be very inter-connected to the current debate.

Long-term investments are currently organised through public and private financing and structured through either regulated or unregulated vehicles. They are generally not open to retail investors, principally due to their lack of liquidity.

The definition of a liquid asset is generally taken to be its ability to be sold or realised within a short period of time with no or limited loss of value; liquidity is therefore not necessarily a key feature of the definition of a long-term investment.

The economic life cycle of long-term investments does not align with the normal liquidity expectations of retail investors. It is therefore likely that a new type of product will need to emerge, which requires a longer term investment horizon. Due to less frequent liquidity requirements, the UCITS and or AIF frameworks may not necessarily provide the best solutions so a new regulatory framework may be required.

III. Channelling LTF from households / Retail Investors

We understand that the Commission is studying how to attract Retail Investor savings to long-term financing. As mentioned in the introduction of the Green Paper, households generally prefer liquidity and easy redemption, in addition they do not have the necessary resources to make the distinction between cyclical and structural shifts in value. For that reason they will tend to buy when the market is high and sell when it is low.

Accordingly we believe that LTF from households should continue to be channelled through the intermediary structures mentioned above. When this is done directly through funds, lock-up investments are not necessarily detrimental for these types of investors as long as it is within a clear structure and the allocation is appropriate to their chosen or advised risk profile and investment goals.

Before looking at new alternatives for channelling LTF it will be important for the Commission to consider the following steps:

- Assessment of existing vehicles for LTI and whether these provide partial or complete propositions to fit the definition above;
- Gaps in the long-term saving offerings in EU, clearly pensions;
- Consideration of suitable tax incentives to encourage households to consider longer-term savings in LTI asset classes and products;
- Possibility of incentives for pension funds and insurance companies to retain assets on their balance sheet that would meet the LTI requirements.

2. THE SUPPLY OF LONG-TERM FINANCING AND CHARACTERISTICS OF LONG-TERM INVESTMENT

Q 1) *Do you agree with the analysis out above regarding the supply and characteristics of long-term financing?*

ALFI generally agrees with the analysis and considerations, which summarisesalbeit high level, the supply and characteristics of long-term financing.

Q 2) *Do you have a view on the most appropriate definition of long-term financing?*

In general, a long-term investment can be characterised as being held through a complete business cycle; whereas the number of years of such cycle may vary considerably depending on the product and type of asset class involved (e.g. in real estate the minimum holding period would usually range from five to seven years; in private equity from three to five years).

Arguably, some may wish to take as a starting point for a definition of long-term financing not the nature of the asset class but rather the investment objective of the investor. In such definition long-term financing could cover a wide range of products and could even include mainstream equity and bond investments (e.g. UCITS funds).

ALFI believes that a definition should not be too broad and should avoid any amalgamation or confusion between for examplethe traditional UCITS and other liquid assets and asset classes, which by nature require long-term engagement. The definition to be used for the purpose of the present initiative should therefore be specific and should be formed around the policy goals the Commission seeks to address. ALFI suggests tofind a generic description of the features of long-term financing, however, without limiting such definition to certain asset classes or markets.

In addition, such definition should not be limited to specific product types. ALFI believes that long-term financing can be achieved and possibly has to be achieved through a number of different and complementary channels. ALFI believes that the fund industry will be able to play a major role in the provision of long-term financing, but consideration should also be given to intermediary structures such as mandatory state organised or complementary pension schemes in this regard as well as the considerations outlined in the answer to question 3 below.

Finally, we welcome the Commission's approach to also consider long-term savings in the context of long-term financing. Although long-term financing should not be limited to long-term savings products, ALFI clearly sees opportunities in providing individuals with a possibility to invest their long-term savings in appropriate long-term financing products.

3. ENHANCING THE LONG-TERM FINANCING OF THE EUROPEAN ECONOMY
3.1. The capacity of financial institutions to channel long-term finance
Commercial banks

Q 3) *Given the evolving nature of the banking sector, going forward, what role do you see forbanks in the channeling of financing to long-term investments?*

Long-term financing can by definition be seen as capital intensive, therefore we believe that banks will continue to remain one of the key providers for financing infrastructure.

Besides very large and prominent projects that could be classified to fall under the concept of "long-term financing" and apart from well-established prominent players that realise such projects, banks intervene as an intermediary between savers/investors and entrepreneurs/borrowers. To make reference to an example mentioned by your Commission in the introduction, banks have pan-European networks through which they are able to finance SMEs, due to their local presence (branches). Otherwise SMEs would have to spend tremendous time and effort in raising finance on public markets.

Key concerns of the banking industry focus on the crowded regulatory agenda (including among others CRD/CRR IV etc.). Arguably, regulatory concerns have been counterbalanced by quantitative easing, the real effect of which has yet to be fully passed on to the market.

Regulatory constraints have led to banks seeking partners with whomthey can jointly fulfil or divest themselves of projects (risk consideration). These partners have been Institutional Investors, mostly funds, which have successfully worked together(bank's ability to lend less following the crisis and regulatory reforms together with equity rich funds).

We would like to draw your attention to specific schemes such as the German Pfandbriefe / covered bonds, where post-crisis issuance of Pfandbriefe continued successfully, avoiding the difficulties that were experienced in other parts of the securitisation markets.

ALFI recognises that in such context the "Project Bonds Initiative" has been discussed to partly provide a solution to Europe's 2020 strategy. In 2011 when project bonds were discussed it was clearly mentioned that such initiative would have to be supported by additional initiatives, one of which clearly needs to be a well thought through long-term investment vehicle.

Finally we would like to direct your attention to the fact that curbs in bank lending has led to direct investment by prominent non-bank market players to act as lenders.

National and multilateral development banks and financial incentives
Q 4) *How could the role of national and multilateral development banks best support thefinancing of long-term investment? Is there scope for greater coordination between thesebanks in the pursuit of EU policy goals? How could financial instruments under the EUbudget better support the financing of long-term investment in sustainable growth?*

National or Multilateral Development Banks ("NDBs", "MDBs") are national or supranational institutions set up by sovereign states, which have the common task of fostering economic and social progress in countries or geographical regions by financing projects, supporting investment and generating capital.

We believe that NDBs/ MDBs have a key role to play as facilitators in granting long-term financing for certain projects (potentially the larger infrastructure projects). Aside from their financial contribution to any project (through direct financing, credit enhancements or guarantees, risk mitigation instruments etc.), they have a wealth of expertise that can support a wide range of projects, ensure sound project governance and be a catalyst for furtherinvestment in any projects by either local authorities, commercial lenders or other private investors.

Public-Private Partnerships ("PPP") between NDBs, MDBs (or governments directly) and private institutional investors are one example of an area that is worth exploring further. PPPs have existed for the last 20 years or so both within the EU, but also in other countries such as Australia or Canada. There are different approaches to PPP, but these projects can be more focused on specific sectors or themes, which can often provide the required incentive for longer term private commitments.

It is however crucial that a holistic approach is taken at an EU level when considering all policy tools and instruments that are available to promote sustainable, long-term projects, ensuring that there is a coherent and synchronised approach to avoid any possible instances where one policy tool or initiative might compete with another, thereby reducing the positive nature of either one.

Q 5) *Are there other public policy tools and frameworks that can support the financing of long-term investment?*

Arguably the most prominent tool to support the financing of long-term investment willbe fiscal incentives. However, we think that the EU needs to create the right incentive structure, avoiding anydistortion of competition within the marketplace, on the one hand, or competition between policy tools or instruments on the other.

<u>Institutional investors</u>

Q 6) *To what extent and how can institutional investors play a greater role in the changinglandscape of long-term financing?*

ALFI is of the opinion that Institutional Investors will by definition play a vital role in long-term financing. As indicated in the Green Paper(life) insurance companies, pension funds and mutual funds already play a vital role in long-term financing already.

We make reference to an OECD Project, which focusespurely on this topic, namely "institutional investors and long-term investment"1. The report identifies that for Institutional Investors to play a prominent role and an even greater role in the future, policy reforms need to be implemented to actively encourage Institutional Investors to play a longer-term role. ALFI agrees with the aim of the OECD report, which was to facilitate long-term investment by institutional investors such as pension funds, insurance companies, and sovereign wealth funds, addressing both potential regulatory obstacles and market failures. We make particular reference to the proposed policy reforms brought forward therein, which suggests that:

i) the regulatory framework for institutional investorsneeds to be improved, including addressing potential unintended short-term incentives in solvency and funding regulations;

[1] http://www.oecd.org/insurance/private-pensions/institutionalinvestorsandlong-terminvestment.htm

ii) policies need to be implemented to encourage active share ownership (allowing collaboration, best practice guides and increased supervisory oversight of pension funds, investment mandates, fees, turnover and voting);

iii) policy frameworks need to be supportive of the envisaged goals; and

iv) the increasingly short supply of long-term capital since the 2008 financial crisis needs to be addressed, which has had profound implications for growth and financial stability.

Furthermore, ALFI sees a clear trend that the alternative fund industry (real estate, private equity and venture capital) equally should be considered in the context of long-term financing. In addition, European incentives by your Commission such as EuVCA and EuSEF should equally be mentioned in this regard.Finally, we encourage the Commission to think about the roles that public policy tools and the aid of national and multilateral development banks and financial incentives can play in connection with setting the scene for Institutional Investors in this regard. We make reference to the answers to questions 4 & 5 above.

Q 7) *How can prudential objectives and the desire to support long-term financing best bebalanced in the design and implementation of the respective prudential rules for insurers,reinsurers and pension funds, such as IORPs?*

There are conflicting objectives at work for IORP's, which is recognised in the Green Paper. Additional protection measures for scheme members (including the proposals for portability or requirements for frequent valuations) directly conflict with the objective of long-term financing and investment. As stated in previous consultations, more regulation in this already heavily regulated area, albeit in the form of "detailed calibration", may run the risk of having an adverse effect on IORP and particularly their long-term investment perspective.

Q 8)*What are the barriers to creating pooled investment vehicles? Could platforms be developed at the EU level?*

In ALFI's view, the barriers that exist are not so much barriers to the creation of a framework for pooled vehicles since appropriate structure exist already. The barriers ALFI sees are more of a practical nature and they result in a situation where existing structures are not used by market players due to the factual issues they encounter. An example for an existing structure is the IORP directive which creates a potential platform for pooled investments across Europe. For reasons linked notably to the administrative burden of running a truly multi-jurisdictional IORP, only few actors have taken the choice to use such legal framework on a cross-jurisdictional basis.

In ALFI's view, there is room (and demand) for workable pan-European platform that allows the achievement of economic of scale without being overly heavy and burdensome in their daily management. ALFI strongly support the Commission's proposals for a long-term investment fund on a EU harmonised basis which, like UCITS, could potentially create a new market for a pan-European (and possibly even worldwide) product label for long-term investments.

Q 9) *What other options and instruments could be considered to enhance the capacity of banksand institutional investors to channel long-term finance?*

ALFI supports the positionset out in the response to the Green Paper by EFAMA.

The combined effects of regulatory reform on financial institutions

Q 10) *Are there any cumulative impacts of current and planned prudential reforms on the level and cyclicality of aggregate long-term investment and how significant are they? How could any impact be best addressed?*

ALFI welcomes the analysis in the Green Paper, which rightly recognises that the current and planned prudential regulatory reforms impact the asset management, banking and insurance industry. For this reason an overall impact assessment, which looks at the cumulative effect of existing reforms that have already been transposed and planned reforms that are still on the horizon, is extremely important.

As outlined in the questions above, to ensure the success of long-term financing as envisaged by the Commission, all reforms that will and already do impact the provision of financing long-term investments of any kind, will need to be closely analysed in their entirety rather than individually.

EU impact assessment

3.2. The efficiency and effectiveness of financial markets to offer long-term financing instruments

Q 11)*How could capital market financing of long-term investment be improved in Europe?*

Q 12) *How can capital markets help fill the equity gap in Europe? What should change in theway market-based intermediation operates to ensure that the financing can better flow tolong-term investments, better support the financing of long-term investment in economically-,socially- and environmentally-sustainable growth and ensuring adequate protection for investors and consumers?*

Q 13)*What are the pros and cons of developing a more harmonised framework for covered bonds? What elements could compose this framework?*

ALFI supports the positionsset out in the responses to the Green Paper by EFAMA.

Q 14) *How could the securitisation market in the EU be revived in order to achieve the rightbalance between financial stability and the need to improve maturity transformation by thefinancial system?*

ALFI supports the positionsset out in the responses to the Green Paper by EFAMA.

3.3 Cross-cutting factors enabling long-term saving and financing

Q 15) *What are the merits of the various models for a specific savings account available within the EU level? Could an EU model be designed?*

An individual retirement product (which may be inspiredby the various models currently existing within different EU Member States) would have the merit that it would be (in principle) suitable for workers that make use of their fundamental freedom enshrined in Article 45 of the Treaty on the Functioning of the European Union.

Occupational pensions solutions have the disadvantage that often they are not adapted to workers' mobility in today's modern world. Minimum contribution periods conflict with today's usual working patterns where it has become rare that an employee stays for his entire working life with one employer as was the case 20 years ago.

A common European framework for individual retirement solutions would have the merit of creating a common knowledge and trust for mobile workers who would find in each European country the same basic principles applied.

The experience with pan-European pension funds suggests that any EU-wide platforms need regulations, which deal also with fiscal and regulatory differences/obstacles for recognition at local level; regulation of certain aspects only will not be sufficient.

ALFI strongly believes that an individual pension framework could be an efficient alternative to current occupational pensions solutions.

Taxation

Q 16) *What type of CIT reforms could improve investment conditions by removing distortions between debt and equity?*

Q 17) *What considerations should be taken into account for setting the right incentives at national level for long-term saving? In particular, how should tax incentives be used to encourage long-term saving in a balanced way?*

Q 18) *Which types of corporate tax incentives are beneficial? What measures could be used to deal with the risks of arbitrage when exemptions/incentives are granted for specific activities?*
Q 19) *Would deeper tax coordination in the EU support the financing of long-term investment?*

ALFI shares your Commission's analysis that carefully thought through tax incentives will be key to encourage long-term financing.

Accounting principles

Q 20)*To what extent do you consider that the use of fair value accounting principles has led toshort-termism in investor behaviour? What alternatives or other ways to compensate for sucheffects could be suggested?*

Understanding the features of the underlying long-term investment is key. ALFI fully supports the answer provided by EFAMA.

Corporate governance arrangements

Q 21) *What kind of incentives could help promote better long-term shareholder engagement?*

Q 22) *How can the mandates and incentives given to asset managers be developed to support long-term investment strategies and relationships?*

ALFI strongly believes that a sound and robust corporate governance framework contributes to encouraging investors to place their money in appropriate products. It has been one of the common efforts after the financial crisis of 2008 to re-establish investor confidence by creating robust, transparent and reliable corporate governance structures. We would support the view that a corporate governance set-up for long-term financing products that is comparable to UCITS management companies and AIFMs would allow investors to understand and put confidence in the relevant product.

Besides corporate governance in terms of daily management of the product ALFI believes that another important factor is risk management. Although it may be difficult to find appropriate standards for a variety of very different long-term investment products, we believe that the existence and information to investors about applicable risk management tools is key to creating investor confidence.

Finally, it appears to us that regular reporting is an essential feature, especially in a long-term financing context where investors cannot follow the performance of the invested assets over stock exchanges or by similar means. It is essential for the education and confidence of investors that meaningful explanations and insight are given on a regular basis so as to avoid the feeling that something is happening to the investors' money but one will only find out in several years' time, when such product comes to maturity.

Q 23)*Is there a need to revisit the definition of fiduciary duty in the context of long-termfinancing?*

ALFIbelieves that there is no need to revisit the definition of the fiduciary duty in the context of long-term financing. The ultimate best interest of the investor is embedded at the heart of our EU legal systems, in particular as regards asset managers under the UCITS and AIFM Directives.

Information and reporting

Q 24)*To what extent can increased integration of financial and non-financial information help provide a clearer overview of a company's long-term performance, and contribute to better investment decision-making?*
Q 25)*Is there a need to develop specific long-term benchmarks?*

ALFI endorses the answer provided by EFAMA.

In addition, there is clearly a trend for non-financial reporting as regards certain market segments such as in real estate (green investing) or socially responsible investing companies subscribing to ESG criteria, among others. Furthermore, less liquid asset classes will need to be measured in order to for investors to properly assess the risk associated with them.

However, prior to identifying a common denominator as regards any type of reliable reporting (whether financial or non-financial) for any type of investment, a (long) learning process is needed and therefore not too much reliance should be placed thereon from the start. Nevertheless, an evolving market will allow for certain parameters to develop and influence the market.

3.4 The ease of SMEs to access bank and non-bank financing

Q 26)*What further steps could be envisaged, in terms of EU regulation or other reforms, to facilitate SME access to alternative sources of finance?*

ALFI fully endorses the answer of EFAMA.

Q 27 – 29) *not answered*

Q 30) *In addition to the analysis and potential measures set out in this Green Paper, what else could contribute to the long-term financing of the European economy?*

ALFI believes that a careful review of existing and proposed regulation together with a coherent and transparent legislative proposal will be vital to ensure successful long-term financing of the European economy. In addition, consideration should be given at European and national level toprudential capital; European passport;fiscal aspects in the hands of retail investors; and aligning reporting requirements with other regimes e.g. AIFMD/Solvency II, among others.

Finally, we believe that a diversity of actors (including funds, institutional and retail investors as well as banks) will be fundamental for a successful financing of long-term investments.