

Monsieur le Président de la République,

■ The COVID-19 pandemic which hit Europe at the end of the winter makes the 2019 Annual Report of the Autorité des Marchés Financiers seem almost anecdotal. This Annual Report presents the AMF's activity in detail and highlights the scale of the work involved in preparing for the United Kingdom's exit from the EU, the PACTE Law on business growth and transformation, and support for an increase in socially responsible investment, etc. However, I naturally wish to draw your attention to the initial effects of the pandemic in the AMF's fields of responsibility.

■ While this pandemic has generated huge shocks which have not spared the financial sector, there is every reason to believe that this crisis will have structural consequences for the functioning of financial markets and the savings channel. It has also illustrated the limitations of international coordination, and, in particular, the current limitations of European integration.

■ In recent weeks, the AMF's action has been driven by the will to support stakeholders and keep all markets open in order to ensure that this mechanism for financing the economy is maintained. On markets, the pandemic has not only triggered an operational crisis due to the massive lockdown of stakeholders, but also a financial crisis due to a drastic revision of the valuations of various assets, and hence, a drastic revision of their liquidity.

■ Quite understandably, issuers are having great difficulty measuring the consequences of the pandemic for their business and their financial situation, even when taking into account the impact of measures taken by governments to offer support. However, in order to keep markets open and maintain the financing they provide, in particular via bond issuance, listed companies are required to carry out regular disclosure of all relevant information concerning the impact of the crisis and their financial outlook. The AMF has assisted issuers with these formalities and has published regular clarifications of its expectations regarding periodic information and on-going information, the accounting treatment of expected loan losses and the organisation of annual general meetings.

■ In parallel, investors have had the greatest of difficulty in analysing the situation and taking the most appropriate asset allocation decisions. Such an environment drives risk premia up and leads investors to focus on the best signatures, giving priority to liquidity. There has been a particularly sharp increase, for example, in bank deposits, while stock market valuations collapsed and liquidity vanished/dried up on numerous segments of the fixed-income markets. Small investors suffered a double hit due to the fall in share prices and to cuts in dividend, or, in many cases, the cancellation of dividends when good 2019 earnings suggested significant payouts. The AMF accordingly received an exceptional number of questions from investors (1,643 in March). In this uncertain environment, some may have been drawn by appealing but fraudulent alternative investment offers. The AMF, in conjunction with the ACPR, therefore had to warn the public against the risk of such scams.

■ Financial intermediation services have had to operate under unprecedented pressure, but was able to perform its duties in an orderly manner.

■ Market infrastructures remained operational despite the widespread adoption of teleworking and very large transaction volumes. Equity markets handled an extremely large volume of transactions (in March, for example, Euronext Paris saw its trading volume multiplied by 2.5 year-on-year) and the extreme price volatility was managed by an unprecedented number of activations of circuit breakers, which make it possible to attenuate market overheating and the risks of a crash.

■ Although the fall in share prices cannot be attributed to massive short selling - in a context where its contribution to satisfactory price formation appeared limited, to say the least, and where its procyclical nature could be potentially disastrous - its increase led to the decision to prohibit new net short positions temporarily. These positions therefore fell, on a comparable structural basis, from 1.03% of the market capitalisation on 16 March (before the ban) to 0.54% on 31 March. There is every reason to believe that this measure, which restricts the capacity for making money from the distress of our economy, did not harm the market's functioning. Clearing houses, for their part, played their role of counterparty risk concentration by adapting their margin calls while avoiding excessive procyclicality. Central securities depositories performed their settlement function without the occasional increase in unsettled transactions causing defaults, which would have been detrimental to financial stability.

■ Asset management is undergoing a genuine stress test. This industry sector is often cited as one of the sources of systemic risk, especially in the case of open-ended funds which are valued daily. Now, more stringent prudential regulations for banks, combined with a highly accommodative monetary policy even in a period of sustained economic growth, have encouraged an increase in financing of the economy by market leverage and the growth in asset management.

■ By definition, the liquidity of a fund corresponds to the liquidity of the assets in which it invests, and experience shows that an asset class' liquidity is never guaranteed. Moreover, even when there is liquidity, an influx of redemption requests means that, unless buying restrictions are introduced, asset disposals are required, which automatically results in fall in prices. The pressure sustained by asset management companies in March therefore comes as no surprise. At that time they had to cope with difficulties over the valuation of certain assets which were no longer traded on the market, and with sometimes significant withdrawals, in particular from money market funds, since firms had to meet unexpected cash management requirements, and margin calls of unprecedented magnitude, notably in the case of positions in derivative instruments.

■ Clearly, investment managers have broadly stepped up to these challenges satisfactorily, even if this is partly due to the European Central Bank's (ECB) announcement to introduce a vast securities purchasing programme known as the PEPP. At the time this letter was written, the only open-ended French funds to have been suspended are employee savings scheme funds invested in unlisted companies, whose underlying assets could not be fairly valued and for which suspension was a means to protect the interests of the investors. The only foreign funds managed by French asset management companies to have been suspended are two small funds with risky profiles.

■ However there should be no ambiguity: when certain market segments become illiquid and regulations prohibit direct support for funds, fund managers must use the tools at their disposal to manage such situations. These tools are extremely clearly structured in France. First, there is the activation of mechanisms which make it possible for unitholders who exit funds to pay for the cost of the portfolio reallocation required as a result of their exit; the AMF has simplified these mechanisms' introduction in order to ensure equal treatment of unitholders. The Sapin Act of December 2016 made it possible to introduce limits on

redemption applications ("*gates*"); however, this mechanism was only adopted by a minority of funds, partly because some insurers do not wish to accept funds with such limits as vehicles for their unit-linked life insurance policies. Clearly, this matter would deserve to be re-examined. Fund managers can also divide a fund up into an illiquid pocket, which is liquidated, and a liquid side pocket, which remains open. This makes it possible to not suspend an entire fund and to ensure a fund's management in the interests of investors in the illiquid pocket. This scheme was regulated by the PACTE Law and all the necessary implementing regulations have been adopted. Finally, there is the suspension which is an initiative taken by the fund manager or at the request of the AMF. The impact of such a decision, which may cover several possible cases (temporary inability to value the assets or liquidity crisis), should be neither overly dramatised nor underestimated, but it would suggest that an extremely clear message should be given when marketing these financial products: their liquidity cannot be guaranteed in all circumstances.

■ Despite the lockdown which has affected almost the whole of its staff, the AMF has been fully mobilised, to ensure fine monitoring of specific situations, an overall analysis of the situation and the adjustment of its regulatory responses. Its staff have been deeply involved in national and international coordination. However, admittedly in the financial markets sector, this has shown the limits to the ambition of having a strong coordinated response in Europe to the challenges posed by the crisis.

■ The episode of the restrictions placed on short selling is a clear illustration of this. Although the European Securities and Markets Authority (ESMA) is capable of activating such a restriction at EU level, a majority was unable to be reached along these lines, and six countries (Austria, Belgium, Spain, France, Greece and Italy) therefore did so on a national basis. Apart from being a disastrous political signal, this raised numerous technical issues: for Euronext, which has a single order book, with stocks on which net short positions are prohibited and others (e.g. Dutch stocks) on which they are authorised; and for European indices such as Eurostoxx, under German responsibility, which can be shorted despite this being prohibited for most of its components, etc.

■ Despite the highly cross-border nature of asset management (asset management company in one country, funds registered in another country and marketed, via the passport scheme,

in the entire Union), the crisis highlighted the diversity of national approaches, with different transpositions of the European directives and non-harmonised liquidity risk management systems. It thus showed the limits to the possible role of ESMA in periods of crisis. While ESMA has proved a precious framework for exchange, analysis and harmonisation of certain supervision schedules or priorities, it is clear that the ability to activate its emergency powers, although stipulated in its founding regulations, would appear highly illusory. It is not able for it to suddenly step in and replace national supervisors in applying non-harmonised regulatory documents or propose emergency measures without being accountable to the stakeholders. More generally, this situation highlights the lack of a rapid response mechanism on the European level: national authorities cannot be brought into line and European authorities are not equipped to impose a European response to the crisis.

■ This illustrates just how far we are from a Capital Markets Union. Yet such a Union is more necessary than ever if we do not want the banking and credit system to stand alone in financing the recovery of our economies. Since ultimately this is clearly the issue. The massive support for our economic fabric, in the form of deferred payments and new lending, is creating an extremely fragile general state of finances at a time when certain sectors are seeing profound changes in their fundamentals and will have to rethink their strategy. Clearly, following support via lending, our European economies will need massive support via shareholders' funds. However, the substantial fall in share prices could be analysed as a buying opportunity and our fellow citizens should be prepared to seize this historic opportunity. Monitoring by the AMF has, for example, identified a market increase in purchases of French equities by retail investors, with 150,000 new investors. This trend should be supported, in line with the ambitious process undertaken by Europe and by France to make our economies sustainable, notably faced with the challenges of climate change. The AMF fully supports this process.

■ Lastly, I would like to draw your attention to the recent decision of the Conseil d'Etat regarding the appeal that I had brought in July 2018 against the refusal of the AMF Enforcement Committee to approve an administrative settlement agreement (transaction agreement) reached with an obliged entity. This refusal (the second in ten years) was justified succinctly, without any other clarification, by the assertion "*that the allegations raise*

new issues concerning the substance which should be settled by the Enforcement Committee". The Conseil d'Etat nevertheless confirmed the refusal of approval, considering that the Enforcement Committee had, in particular, to check that the agreement was not "*inappropriate with respect to the requirement of punishment of regulatory breaches*" and that, moreover, the justification for a refusal could be given "*succinctly*". This decision was publicised extensively by the Conseil d'Etat which, on this occasion, termed the content of an administrative settlement agreement a "sanction".

■ In light of this decision of the Conseil d'Etat, it is now becoming problematic, to say the least, both for the AMF Board and for those accused, to enter the process of settlement proceedings given that the agreement, once reached, will now be termed a "sanction", even though it avoids any recognition of guilt, and knowing, moreover, that it might not be approved because it could be considered inappropriate, and with a succinct justification. The AMF Board therefore wishes for a change in the legislation to be able to protect a procedure which, as on the day of the Conseil d'Etat's decision, has made it possible to deal quickly and satisfactorily with more than 80 cases.

■ The Autorité des Marchés Financiers is determined to contribute to the recovery of our economy by aligning, insofar as possible, the interests of enterprises, savers and the finance industry. It must itself evolve and draw all the lessons from this lockdown period, which has occurred at a time when it was re-examining its internal organisation and which has led it to work differently. I draw your attention to the need to ensure its permanent financial equilibrium when, in the present context, a reduction in the contributions that it receives from its obliged entities can be expected, and when all its financial margins have been paid into the central government's budget in recent years.

■ Yours sincerely and respectfully,

Robert Ophèle

Chairman, Autorité des Marchés Financiers

