EBI'S ACADEMIC CONFERENCE ON REGULATING AND SUPERVISING CAPITAL MARKETS IN THE EU. TRENDS AND CHALLENGES

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THE ACCESS TO CAPITAL MARKETS BY COMPANIES IN THE EU AND THE REGULATION OF TRADING VENUES

GUIDO FERRARINI
EBI & University of Genoa,
Centre for Law and Finance

UNIVERSITÀ DEGLI STUDI DI GENOVA

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1. Introduction

- An old theme in a renewed context
  - Stock exchanges (trading venues) are different
    - Main role as liquidity providers
    - Smaller role as rules/reputation providers

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1. Introduction

- Regulation is more demanding
  - Higher costs for corporations
  - Potential obstacle to SMEs
- Alternatives are interesting
  - private equity
  - private markets
- Eclipse of the public corporation?

2. Decline in Listings and Public Policy

A) Primary and secondary equity markets in the EU (2020)

- Final Report by Oxera Consulting for the European Commission, November 2020
  - Public equity markets provide <u>substantial social benefits</u>
  - However, Europe's public equity markets <u>have fallen behind in global terms</u>
    - They are much smaller than those in the USA and Asia
    - The number of listings in the EU-28 declined by 12%, from 7,392 in 2010 to 6,538 in 2018, while GDP grew by 24% over the same period

2. Decline in Listings and Public Policy

- What drives the decline in listings?
  - The decision to list depends on the net benefits to a firm of going public outweighing any negative impacts
    - The initial and ongoing costs of becoming a public company have risen considerably in recent decades, and widened the gap between public and private companies
    - Increased M&A activity along with the development of private equity markets are identified as the major driving forces for the decline in listings
    - Regulation is not the primary driver of the decline in listings, but there is room for modernisation and streamlining of the listing rules

2. Decline in Listings and Public Policy

- What can policymakers do to encourage EU listings?
  - Revisiting the rules around disclosure to reduce the imbalance between private and public companies
  - Encouraging flexibility in the use of dual-class shares where national rules or practices prevent this
  - Promoting institutional investor participation in IPOs
  - Improving corporate governance standards to keep down agency costs
  - Attracting retail investors, a potentially large source of capital, to invest in public equity markets

2. Decline in Listings and Public Policy

B) CMU New Action Plan (2020)

- To better integrate national capital markets and facilitate companies' access to market funding, the legal environment needs to deliver the right balance between
    - providing relevant information about investment opportunities to investors and
    - minimising the burden for companies to report this information

- The Commission will tackle the lack of accessible and comparable company data for investors
    - Action 1: The Commission will propose to set up an EU-wide platform (European single access point) that provides investors with seamless access to financial and sustainability- related company information

2. Decline in Listings and Public Policy

- Public listing is too cumbersome and costly, especially for SMEs
  - Targeted simplification of existing listing rules will reduce compliance costs for SMEs
  - well-calibrated simplification of existing rules will allow for a more proportionate treatment of SMEs without impairing market integrity and investor protection
- Action 2: In order to promote and diversify small and innovative companies' access to funding, the Commission will seek to simplify the listing rules for public markets.

2. Decline in Listings and Public Policy

C) The "Listing Act" consultation (2021)

- The current EU rules relevant for company listing consist of provisions contained in a number of legal acts, such as the
  - Prospectus Regulation
  - the Market Abuse Regulation (MAR)
  - the Market in Financial Instruments Directive (MiFID II) and Regulation (MiFIR)
  - the Transparency Directive
  - the Listing Directive

2. Decline in Listings and Public Policy

- These Listing rules primarily aim at balancing the facilitation of companies' access to EU public markets with an adequate level of investor protection

- However, public listing in the EU is currently too cumbersome and costly, especially for SMEs

3. Are SME Growth Markets the Solution?

A) MiFID II and ESMA Final Report

- Article 33(3) MiFID II establishes the conditions which an MTF has to satisfy when applying to its NCA to be registered as an SME GM
    - To include a 50% threshold on the minimum number of SME issuers traded on the SME GM
    - appropriate criteria for initial and ongoing admission to trading
    - sufficient information published and appropriate ongoing financial reporting of issuers
    - dissemination of information to the public and compliance with systems and controls under the Market Abuse Regulation (MAR)

3. Are SME Growth Markets the Solution?

- ESMA, *MiFID II Review Report on the Functioning of the Regime for SME Growth Markets (2021)* aims at identifying solutions that should facilitate the functioning of SME GMs and foster investment in SME securities
  - The Report suggests that the MiFID II regime has been relatively successful, with seventeen MTFs registering as SME GMs to date
  - it also suggests targeted amendments to the SME GM regime in the MiFID II framework, aiming at simplifying investors' access to information and promoting concentration of liquidity on SME GMs
- Articles 77 to 79 of CDR (EU) 2017/565 further specify the criteria to be used by MTFs to (i) identify companies that qualify as SMEs for the purpose of the SME GM label and, (ii) register/deregister as an SME GM

3. Are SME Growth Markets the Solution?

B) Recent amendment to MAR and Prospectus Regulation

- Specific provisions creating tailored requirements and incentives for SME issuers trading on SME GMs have been included in several regulations

- Recent amendments to MAR provide alleviations for the publication of insider lists for issuers on SME GMs and aim at facilitating the provision of liquidity for such issuers through the creation of an EU framework for liquidity contracts

- The Prospectus Regulation also offers some alleviation in terms of requirements for SME issuers

- The CSDR and related Level 2 Regulations provide for less stringent settlement discipline measures regarding SME GM transactions

3. Are SME Growth Markets the Solution?

C) ESMA assessments and recommendations

Homogeneous admission requirements?

- Respondents did not support the creation of a harmonised regime in terms of admission requirements, as this could potentially increase costs for issuers

- ESMA believes that in the medium-term standardising requirements across the EU could incentivise the growth of SME GMs and foster cross border investment

3. Are SME Growth Markets the Solution?

Backward looking disclosure of information?

- Respondents did not support the proposal to make available the information requested in Article 78(2)(h) of CDR (EU) 2017/565 for issuers admitted to trading on an SME GM up to one year before such admission to trading takes place

- ESMA believes that an amendment requiring to make financial reports in the year prior to admission to trading public where available could help investors to retrieve helpful information

3. Are SME Growth Markets the Solution?

Standardization of periodic financial information?

- The standardisation of periodic financial information could be burdensome for SMEs across the EU

- However, ESMA believes that in the long term this could be beneficial and suggests such proposal could be considered in the context of the ongoing discussion on the ESAP

3. Are SME Growth Markets the Solution?

Creating a two-tier regime for Small and Medium SME?

- Given the feedback received to the consultation, ESMA does not believe that it is effective to propose the creation of a two-tier regime for SMEs

- With respect to the creation of segments targeting micro SMEs which would be accessible *only to professional investors* and entailing some possible legislative alleviations, ESMA could see merits in investigating further if such initiative could foster micro SMEs interest in public markets

3. Are SME Growth Markets the Solution?

Mandatory liquidity provision schemes?

- Liquidity provision schemes introduced by venues can support liquidity for SME issuers, but the cost of such schemes might be incurred by issuers themselves
- Therefore, ESMA does not suggest the introduction of mandatory liquidity provision schemes
  - However, incentivising more liquidity on those SMG GMs remains a key challenge and objective
  - the recent amendments to MAR regulation and the RTS on liquidity contracts delivered in October 2020 to the EC give the possibility to SME issuers to enter into liquidity contracts in absence of an accepted market practice at the national level when further liquidity provision is needed

3. Are SME Growth Markets the Solution?

Issuer non-objection

- It would be beneficial to extend the issuer non-objection requirement in the first part of Article 33(7) of MiFID II concerning the admission to trading of an instrument already admitted on SME GMs to any trading venue
  - Such extension would be beneficial in reducing the risks of fragmentation of liquidity and provide the issuer with some control over the risk of split liquidity
  - ESMA proposes a Level 1 amendment, specifying that if an issuer is admitted to trading on one SME growth market, the financial instrument may also be traded on any other Trading Venue, only where the issuer has been informed and has not objected

3. Are SME Growth Markets the Solution?

Research

- Respondents identified a wide variety of proposals to address the lack of availability of investment research on SMEs
- The Recovery Package, among other recovery measures linked to the COVID-19 pandemic, has introduced a 'narrowly defined exception' for investment research on SMEs from the MiFID II unbundling regime
- ESMA has decided not to tackle this topic in the context of its Final Report

4. The Case of SME Bonds

- In the CP, ESMA raised a question on the reasons for a rather limited activity on SME GMs regarding bonds

    - Respondents indicated a variety of reasons for this limited activity

    - As potential regulatory improvements, respondents indicated that MAR requirements should be alleviated for SME bond issuers, in particular with regards to the insider list and the duty to notify transactions carried out by persons with managerial responsibilities.

    - Some respondents suggested alleviations regarding the publication documents for SME issuers, such as annual financial reports required under Article 33(3)(d) of MIFID II

4. The Case of SME Bonds

- ESMA acknowledges that there are several determinants for the limited amount of bond issuances by SMEs

  - Regarding potential alleviation of MAR provisions for SME issuers, MAR establishes a minimum set of requirements to ensure the integrity of the markets and also envisages exceptions (e.g. accepted market practices, buy-back programmes or stabilisation)

  - However, recent amendments to MAR introduced by the SME GM Regulation envisage specific MAR alleviations for SMEs and the discussion on possible further alleviations to MAR requirements specifically targeting SMEs is currently ongoing at the EC level

4. The Case of SME Bonds

- Italian experience as to SMEs' bonds (see Azimut Direct, *Barometro minibond*)
  - Since the start of the minibond market in 2004 (following legislative and tax changes), 1373 minibonds were issued by 937 issuers, for a total of Euro 9 billion
  - Since 2018 the minibond market has become more mature, while information on private placements is more readily available
    - In the last 4 years, 1050 minibonds were issued, of which 149 listed on ExtraMOT Pro (an MTF run by Borsa Italiana) and 901 privately placed, for a total of Euro 6 billion
    - The role of private markets is on the rise: in the first 9 months of 2022 the private placement share was 94%

5. Conclusions

- The current eclipse of the public corporation in Europe is due to several causes
  - Important alternatives to stock exchange listing
    - private equity
    - private placements (of either shares or bonds)
    - m&a transactions
  - Admission of corporate securities to SME Growth Markets
    - Not a listing in the technical sense
    - Application of milder requirements
    - Still public markets

5. Conclusions

- Burden of regulatory requirements
  - Costs of disclosure and MAR
  - Lighter for large firms given economies of scale
- Capital market alternatives
  - Bond financing either on public or private markets
  - Equity crowdfunding for SMEs
  - ICOs and crypto-assets (in perspective)

5. Conclusions

- Should we grieve for the decline of listings?
    - Not necessarily, to the extent that there are efficient alternatives for the financing of enterprises
        - We should rather try to reduce the initial and ongoing costs of listing, but only to the extent that investor protection is not seriously affected
        - Trading venues still have an essential role in the financing and monitoring of enterprises, while their competition with other providers of funds should not be unduly restricted by regulatory choices
    - In the end, governments should let the markets decide on the best allocation of financing activities between public and private markets in a given system

Thank you!

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