FEDERATION OF EUROPEAN SECURITIES EXCHANGES

FESE RESPONSE
OECD 'DRAFT HIGH-LEVEL PRINCIPLES OF LONG-TERM INVESTMENT FINANCING BY INSTITUTIONAL INVESTORS'

1. Introduction

- The Federation of European Securities Exchanges (FESE) represents 46 exchanges active in equities, bonds, derivatives and commodities through 21 full members from 30 countries, as well as 7 observer members from European emerging markets. FESE is a keen defender of cross-border competition and many of its members have become multi-jurisdictional exchanges, providing market access across multiple investor communities. FESE members operate Regulated Markets (RMs), which provide both institutional and retail investors with transparent and neutral price-formation.
- FESE members have an intrinsic interest in the financing of long-term investments in the economy. Our member exchanges have long been located in every country within Europe, and have financed the needs of companies of all sizes through a wide range of instruments (equity, bonds and derivatives) for decades. They have allowed companies to grow, and employ, by having access to deep pools of liquidity and therefore capital formation at critical stages of their development.
- It is precisely this central role exchanges play that has allowed them to witness first-hand the significant negative changes occurring in European capital markets. Regulation aimed at integration and some aspects of technology have together given capital markets an excessive focus on the needs of a small sub-segment of the economy – the trading of blue chips, ie the largest and most liquid traded companies – at the expense of the needs of the much more numerous but smaller listed companies that play a critical role in growth and employment in Europe. Moreover, these changes have made it much more difficult and less advantageous for the great majority of unlisted companies to consider accessing capital markets.
- The trends indeed show that European capital markets are doing well in terms of turnover but the provision of fresh capital to new companies is more limited. By most measures, the pipeline of new companies is diminishing, with devastating consequences for the rest of the economy. Fewer Initial Public Offerings (IPOs) mean fewer jobs created in Europe. 90% of jobs created by listed companies are created post-IPO. A big part of job growth comes from the mid-size enterprise segment. Fewer IPOs also means less collective ownership of dynamic companies, loss of the discipline and guidance that fuel further enterprise growth, and less equitable wealth distribution for investors. Furthermore, fewer IPOs means investors chasing a shrinking pool of assets, with less diversification and greater instability resulting in less opportunities for saving for retirement.
- It is important to note that these trends are not the result of any specific decisions taken by the stock exchanges (or indeed other market participants). Stock exchanges have done their best to continue to provide mechanisms to facilitate fresh capital formation by companies of all sizes despite the obstacles created by the policy environment and structural changes in the market (which we describe below). We believe that OECD regulators and governments should evaluate the impact of the EU financial sector on the real economy and to put into place policies that can help the economy get back into a path of sustainable growth.

2. Our views on the Draft OECD Principles

- FESE members support all of the principles outlined by the OECD in its report 'Draft high-level principles of long-term investment financing by institutional investors'. In particular, we recommend the following:
    - **Regulators should take steps to repair the local ecosystem**, taking actions that would help revive local brokers so they can help smaller companies access capital markets.
    - **Future OECD policy should further strengthen investor protection, which during the financial was demonstrated to be weak in unregulated parts of he market, and safeguard investor confidence in markets.** Improving investor protection is needed to help increase confidence in markets. We also recommend increasing greater possibilities of certain types of investors accessing markets directly.
    - **Public funds should be used not only to help venture capital funds investing in companies but also help local companies access public capital markets**. The European Commission is already committed to providing funds for private funds such as private equity and venture capital funds that invest in Small and Medium Enterprises (SMEs). Focusing on private equity only will be too narrow, SMEs need

both private equity capital and public markets. We recommend that the funding for venture capital should only focus on early phase SMEs. The EU should allocate some funding to make SME IPOs more attractive to private investors. Public funds could act as a domestic anchor for investors by funding a 'fund of listed SMEs', incentivising other domestic and foreign funds to join in.

- **Bond markets and securitization should be harmonized further** to create additional liquid instruments that can help channel long-term funds to companies.
- **Regulatory incentives that distort investor decisions in favour of some asset classes should be removed,** such as tax/balance sheet incentive to issue bonds**.**
- **Tax incentives that distort investor decisions in favour of some asset classes should be removed**. Moreover, positive tax incentives are needed, in particular for SMEs. If Europe wants more investors to look at SMEs, incentives are needed, and tax incentives are among the most effective. Incentives on taxation for the smaller and most dynamic companies will be a key instrument.
- **Finally, we recommend setting up public/private partnerships to produce and disseminate high quality and credible research on SMEs**. Where good research exists, it still needs to be widely available. Therefore we suggest the creation or provision of funding for an EU-wide information/guideline website for SMEs. The website could serve potential investors for SMEs listed on European Markets.