

FESE views on the TESG Report on SMEs

7th October 2021, Brussels

FESE Members fully support the goal of the Capital Markets Union (CMU) to strengthen the European economy and ensure easier access to markets for companies, notably small and medium-sized enterprises (SMEs) which are the backbone and engine of the European economy. To ensure the success of the CMU, FESE believes that it is key to boost the development of smaller capital markets where most companies are SMEs and where an investment gap is present.

Exchanges provide the infrastructure for public capital markets and offer an alternative source to bank financing for capital raising. Exchanges are fair, orderly, and transparent marketplaces where companies access capital by meeting private and institutional investors in exchange for returns. The primary market plays a vital role in helping companies raise capital to finance innovation and growth.

In SME Growth Markets (SME GMs) there is a continuous dialogue among the various participants about improving the regime so that it is better tailored to the needs of SMEs, thus increasing its attractiveness. It is important to find the best balance between maintaining a liquid and trusted market with reduced burdens for issuers and adequate levels of investor protection.

In this context, FESE welcomes the findings of the final report of the Technical Expert Stakeholder Group (TESG) on SMEs¹ and wishes to provide feedback on some key areas.

1. A holistic approach

FESE strongly recommends that the Commission take a more holistic approach in reviewing the EU regulatory framework. In this regard, the Commission should cover the different regulatory topics that together provide a basis for companies' access to capital markets. We believe that any legislative initiative focused on listings (or capital markets as a whole) should benefit from an integrated approach. The following will be essential:

- A clear benchmarking of Regulations' market outcomes against the initial objectives.
- Economic impact assessments that include a strong focus on the macroeconomic impact of Regulations on the national and local ecosystems which support public capital markets.
- A comprehensive approach covering all participants in the market ecosystem and value chain, particularly when it comes to determining end-user costs.

¹ Technical Expert Stakeholder Group on SMEs. "Empowering EU capital markets for SMEs / Making listing cool again", May 2021.

Future legislative proposals should be based on such a comprehensive review process, with proposals required to demonstrate a clear relevance and benefit to the development of the CMU agenda. This translates in practice to each initiative having to demonstrate empirically via a thorough analysis and impact assessment its value to the CMU.

2. A common definition of SMEs

Currently, SME definitions vary widely throughout financial services legislation, which leads to inconsistencies between legislative files, in turn increasing legal complexity with regards to the applicable rules, and the real potential of fragmentation in the single market. We believe that the definition of SMEs should be aligned (at least) in MiFID II, Prospectus Regulation, ELTIF Regulation, EuVECA Regulation, and Market Abuse Regulation. We agree with the findings of the SME Report and the conclusions of the CMU High-level Forum (HLF) to incorporate the concept of Small and Medium Capitalisation Companies (SMCs) - as those that do not exceed a market capitalisation threshold of EUR 1 billion over a 12-month period - by either amending the existing SME definition of the legislation (e.g. in MiFID II) or by complementing it with a separate clause (e.g. in the Prospectus Regulation). With regards to state aid rules, a simplification of the SME definition should also be carefully considered, alongside the application of a higher threshold.

The new SME definition would encompass a larger number of small companies able to benefit from SME-targeted policies and the GMs regime, and it could also lead to more liquidity in the market. Therefore, we fully support recommendations 1.A and 1.B from the SME Report. More specifically, under the regulatory framework of:

- MiFID II, the SME definition in Article 4(1)(13) should be changed to incorporate the concept of SMC.
- The Prospectus Regulation, the SME definition in Article 2(1)(f)(ii) should be amended to include the above changes in the new MiFID II SMC definition and SMCs should then be referenced in Article 15, with the thresholds to be increased accordingly (referred to in Article 15(1)(b) and (ca)).

3. Reforming listing requirements

While the intention behind creating SME GMs was to attract smaller companies to listing, feedback from FESE Members indicates that issuers' interest in listing on an SME GM remains low compared to that for MTFs, because the differences in requirements are limited, making it difficult to distinguish and promote SME GMs. Hence, we believe it is necessary to continue to increase the attractiveness of capital market financing in certified GMs for SMEs. Access to the market should be further simplified by making technical adjustments to the European regulatory framework. To deliver on the policy objective, SME GMs should be further strengthened to incentivise the listing of SMEs.

As highlighted in the SME Report, the numerous requirements that increase the direct and indirect costs of listing for SMEs are one of the deterrents for companies to list. As stated above, we believe it is important to find a balance between maintaining a liquid and trusted market with reduced burdens for issuers and adequate levels of investor protection. SME GMs should retain a certain level of flexibility whilst ensuring efficiency and integrity. It is important to attract SMEs to the market, both by supporting local ecosystems that create favourable listing conditions and by facilitating cross-border listings for issuers when this provides further opportunities. In this sense, we support the recommendations made in the SME Report in chapter 3.1 to a large extent.

In particular, FESE supports recommendation 2.B on the proposal to make permanent the Recovery Prospectus regime (effective from March 2021 in the context of the ongoing Covid-19 pandemic). This would lead to the creation of a permanent simplified prospectus regime

for secondary issuances and facilitate the transfers from SME GMs to Regulated Markets. The Recovery Prospectus lays down principles of vital importance by recognising that listed companies are already transparent and that any prospectus for follow-on issuance should focus only on new information related to that specific transaction. This would mean modifying Article 14(a) of the Prospectus Regulation to allow a prospectus to be developed that is easy to produce for issuers that want to raise equity (or debt) on capital markets, whilst ensuring the same level of investor protection. In this regard, we would also like to highlight that we have welcomed the amendments to the Prospectus Regulation 2017/1129 by Commission Delegated Regulation (EU) 2019/980 of 14 March 2019. In particular, we endorse the introduction of a simplified prospectus that can be used by issuers listed on an SME GM to obtain admission to trading on a Regulated Market. As the issuer on an SME GM already complies with transparency requirements, we would also consider it reasonable to allow issuers, whose securities have already been traded on an SME GM for a certain period of time and who have prepared an EU Growth Prospectus, to be admitted to trading on a regulated market without having to prepare another prospectus.

Regarding recommendation 2.D, we believe that the use of English broadens the investor base and can be beneficial for SMEs in terms of diversification and liquidity. Nevertheless, the use of English should be optional since for a lot of SMEs the potential investor base is predominantly national, at least in the first phases. Hence, the use of the local language is preferable.

4. Simplify the market abuse regime

Alleviations introduced for SME GMs are expected to bring benefits and reduce costs and efforts for SMEs listed on these markets. However, the market feedback we have received shows a broad perception that the planned alleviations are insufficient. The Market Abuse Regulation (MAR) regime is particularly onerous and cumbersome for SMEs. For instance, due to the application of MAR to companies listed on GMs, issuers on these specialised markets still need to a large extent to apply the requirements in place on main markets. This discourages smaller companies who face rising compliance costs and hence prefer to rely on private equity or even de-list.

SMEs often have fewer employees which makes it even more challenging to meet the regulatory requirements. Therefore, alleviations on SME GMs remain limited from an issuer's perspective. The legal costs of preparing the documentation and carrying out the required due diligence for listing on a public market are often considered prohibitive. Contractual documentation in private placements is standardised and perceived as much more cost-effective. Therefore, FESE shares the perspective held by many issuers that more significant alleviations are required to the MAR regime.

MAR requires all issuers of financial instruments to notify the market of inside information. A more proportionate approach is needed going forward as SMEs may be disincentivised by the comparatively high regulatory burden.

We generally believe that MAR should be further adapted and simplified. With specific regard to SMEs, we propose:

- Differentiation for SME GMs in terms of disclosure requirements with respect to other market segments (e.g. dissemination of information); the required level of detail of insider lists should be reduced (beyond Regulation (EU) No 2019/2115) for SME GMs and include only the minimum fields necessary for supervisory purposes, as proposed by ESMA with the draft ITS for insider lists for SME GMs submitted to the European Commission in 2020 (recommendation 3.B).
- Requirements in relation to managers' transaction reporting should be proportionately tied to the level of market capitalization (recommendation 3.C).

With regards to all issuers:

- The disclosure requirements, notably around information dissemination, should be clarified, especially in relation to what constitutes inside information and when it should be disclosed (recommendation 3.A).
- The obligation to react to rumours related to inside information creates uncertainty as to when a rumour is sufficiently precise to lead to immediate disclosure and should therefore be clarified.
- Establish a more proportionate punitive regime, especially to remove the possibility of criminal sanctions in instances of misconduct involving lesser criminal severity, e.g. in the delayed disclosure of inside information (Art. 17 MAR), insider lists (Art. 18 MAR) and the notification of manager transactions (Art. 19 MAR) (recommendation 3.D).
- We also recommend amending MAR and the ESMA draft regulatory technical standard on liquidity contracts so that market operators are not required to “agree to the contracts’ terms and conditions”, defined by issuers and investments firms, for liquidity contracts used in the framework of GMs (recommendation 3.E). While NCAs must be informed of the existence of liquidity contracts, trading venues are not involved in the issuer liquidity contract agreement. Therefore, market operators should not have to agree to their terms.
- Clarification on the interpretation of the necessary speed around an ad hoc announcement.

5. Dual class shares

FESE supports the introduction of an option into EU law for issuers to adopt multiple voting rights structures, such as dual class shares (recommendation 4). We also note that the CMU HLF expressed support for such an option: *“Companies should have a choice to opt for dual-class shares with variable voting rights when going public [...] to the extent it does not disincentivise investors from investing in companies.”*²

We would suggest opting for a permanent (i.e. not a sandbox) general framework at the EU level to ensure that all Member States include such option. However, the detailed framework design should rather be done at the national level to adapt to the local ecosystem and needs of local investors.

6. Increasing SMCs visibility and profile

FESE supports the creation of an EU Champion label (recommendation 6) to shine a spotlight on the best-in-class EU SMCs. However, we would advise refining the parameters for the eligibility of this label based on sound analysis of the European SMEs ecosystem.

We share the Oxera report’s assessment³ that branding and visibility are important parts of a company’s listing decision and equally believe that there is a need for initiatives aimed at promoting SMCs’ success to attract both retail and institutional investors. This could be supported by a dedicated index which would support the liquidity of the underlying constituents, attract equity research, and increase the companies’ respective profiles.

² CMU HLF final report ([here](#)), p. 66

³ Oxera Consulting LLP, *Primary and secondary equity markets in the EU. Final Report*, November 2020, <https://www.oxera.com/wp-content/uploads/2020/11/Oxera-study-Primary-and-Secondary-Markets-in-the-EU-Final-Report-EN-1.pdf>.

As mentioned, we believe that equity research is a necessary tool to increase SMCs' visibility and should therefore be promoted. The European Regional Development Fund (ERDF) - and possibly European Bank for Reconstruction and Development (EBRD) funds - can efficiently support both independent and sponsored SMC research (recommendation 7.B).

7. Investor categorisation

We would support the introduction of an additional client category of investors (semi-professional) if the inclusion of such a new category leads to an increase in the accessibility of financial instruments currently out of reach for non-professional investors (recommendation 12).

This proposal would apply to a newly created category of investors that have sufficient experience and financial means to understand the risks. Such a definition should not be linked to a specific profession but rather experience, knowledge and risk profile.

In our opinion, the creation of such an additional category of clients would enhance investors' participation in the markets, ultimately supporting the growth of the European economy, with particular reference to SMEs and market infrastructures. The introduction of this new category could facilitate investors' access to a variety of alternative kinds of investments (either liquid or illiquid) in addition to shares, such as Alternative Investment Funds (AIFs), fixed income securities (e.g. corporate bonds), real estate, and securitisations instruments, provided that it is accompanied by appropriate investor protection rules.

8. Creating tax incentives

In our view, a key factor for the success of a market is the increased size of the investor pool. Today, the main investors in SMEs are primarily large institutional investors (mostly of a foreign nature), managing portfolios not necessarily dedicated to the SME asset class. In the countries where FESE Members are active, many SMEs are interested in undertaking an IPO.

In recent years, local advisors and investors in the EU have made significant cost-cutting efforts and consolidated their operations. The combination of these two factors has led to investors shifting their focus to large capitalisation deals and investments.

We believe there should be a focus on attracting investors and increasing participation rates locally, nationally and at the EU level to the benefit of SMEs listed on European capital markets. This would also ultimately contribute to attracting SME IPO candidates. As a general comment, FESE believes that tax incentives are a very important instrument in this area, to enhance the attractiveness of public markets for SMEs. Nevertheless, tax incentives should not replace deeper structural reforms in several areas, mentioned in the sections above.

We fully support the TESG's recommendation 11 to review the Risk Finance Guidelines (RFG) to broaden the definition of eligible undertakings which may benefit from targeted and well-designed tax incentives. We believe this can have a significant positive impact both on companies seeking access to public equity financing and on financial intermediaries assisting these companies.

More specifically, the Commission should consider enabling Member States to support SMEs facing difficulties in gaining access to capital markets by:

- Including a definition of a Small and Medium Capitalisation Company (SMC) - as SMEs listed on alternative venues (MTFs or SME Growth Markets) with a market capitalisation of €1 billion (as proposed in recommendation 1.A) in the Risk Finance Guidelines - to allow a higher number of smaller companies to benefit from tax incentives compatible with State Aid rules.

- Amending Article 24(2) of the General Block Exemption Regulation (GBER) to clarify that aid for scouting costs can be extended to support SME investment research in unlisted SMEs.
- Clarifying that studies (commissioned and funded by the Commission) attesting the existing public equity capital market failure in the EU may be used by Member States to prove such failure in the clearance procedure.

Additionally, FESE believes that the Commission should:

- Consider encouraging Member States to introduce tax benefits to stimulate investors' participation in SMEs listed in their jurisdictions. For example, we believe that SME market segments could be relieved of dividend tax for investors investing in listed SMEs.
- Promote the creation of SME dedicated investment vehicles, encouraging individual investors to pursue either an active or passive investment strategy on capital markets. This can be done by introducing tax incentives that have proven to be effective in the past (e.g. in France with the creation of the PEA-PME investment vehicle).
- Consider encouraging Member States to stimulate the SME market segment by using government-funded repayable loans to cover SMEs' IPO expenses, repayable by the SME after it has raised funding on public markets. This would help SMEs cover pre-IPO costs for roadshows and advisory services (audit, equity, communication, etc.).
- Consider extending the scope of the GBER to include debt instruments, allowing SMEs issuers of debt instruments listed on multilateral trade facilities to benefit from the measures provided by the Guidelines.