

FESE Response to the European Commission's Regulatory Initiative to Promote SME Growth Markets

Introduction

FESE Members welcome the measures proposed by the European Commission to support small and medium-sized enterprises' (SMEs) access to financing through public markets and to promote the use of SME Growth Markets. Furthermore, the recent first draft of the ECON Report on this dossier is a positive development in achieving the goals outlined in the original proposal.

We fully support the work of policy makers in the context of the Capital Markets Union Agenda and their goal to strengthen the European economy and ensure easier access to markets for all companies, including growth companies which are the backbone and engine of the economy.

In this regard, we fully endorse both the Level I measures presented by the Commission to encourage SMEs listings and the Level II amendments to the Delegated Regulation under MiFID II. SMEs are critical to European economic recovery and to accomplishing the EU's goals of job creation, competitiveness and growth. As the basis for these goals, SMEs require a favourable environment, which allows them to meet their financing needs, in particular when accessing markets. Therefore, we support the work of EU decision-makers to ensure a comprehensive strategy on how to boost equity and non-equity financing at all stages of the funding escalator.

Many FESE Members organise specialised markets that allow SMEs across Europe to access capital markets. At the end of October 2018, 1,314 companies were listed in these specialised markets/segments, increasing choice for investors and issuers. On these markets, there is a continuous dialogue among various participants in the ecosystem about improving the listing rules, always with the aim of finding the best balance to maintain a liquid and trusted market for all with reduced burdens for issuers and adequate levels of investors protection. For these reasons, the experience of FESE Members is that more **flexibility** on listing rules supports the better functioning and the integrity of the market.

Comments to the Proposals amending the Prospectus Regulation and MiFID II

Clarifying the definition of non-equity SME

We would like to take this opportunity **to ask for a clarification on the articulation between the SMEs definitions under the Prospectus Regulation vis-à-vis this new amended definition of non-equity SMEs under MiFID II Level II.** Indeed, we welcome the Commission's intent to facilitate the registration of SME Growth Markets specialised in bonds, however we question whether the SME definition in the Prospectus Regulation referring to MiFID II Level I, automatically encompasses the new definition of a non-equity SME in MiFID II Level II, as proposed by the Commission.

To avoid legal uncertainty, in Art. 2 (f)(ii) of the Prospectus Regulation it should be made fully clear that the reference to the SME definition as referred to Art. 4(13) of MiFID II also incorporates the related definitions distinguishing equity and non-equity as set out in Art. 77 of MiFID II Level II (Delegated Regulation EU 2017/565 – now being amended by the Commission).

This would eliminate the risk of non-equity SME issuers (meeting the revised definitions under MiFID II) not being able to avail themselves of the EU Growth Prospectus under the Prospectus Regulation. Otherwise, there is a potential risk that issuers of non-equity that meet the new definition in MiFID II (where the total size of debt issuances does not exceed EUR 50m over a period of 12 months) will not be able to avail of the EU Growth Prospectus regime as set out in the Prospectus Regulation.

We therefore suggest that consideration could be given to amending Art 2(f)(ii) as follows:

FESE Proposal:

Prospectus Regulation Art 2(f)(ii) should be amended as follows:

(ii) Small and medium enterprises as defined in point (13) of Article 4(1) of Directive 2014/65/EU with reference to Art 77 of Delegated Regulation EU2017/565 as amended.

Definition of an SME Growth Market Equity Issuer

FESE members welcome the European Parliament's draft report proposing a review of the MiFID II SME definition which would see an increase in the threshold for the market capitalisation up to EUR 750m. The current qualifying threshold for SMEs of EUR 200m is too low, and only takes into consideration small enterprises and not mid-caps. Whilst FESE maintains its support for a EUR 1bn threshold, this proposal is understood as a step in the right direction.

It would also offer the alternative of defining an SME as those companies whose market capitalisation is less than 35% of the average of the Regulated Market where the company is listed. It would help contribute to a strengthening of SME Growth Markets' ability to attract more companies, with the potential to increase liquidity on these markets.

Furthermore, we support the introduction of a **tentative market capitalisation criterion** for the prospective new issuers set at EUR 750m in the draft ECON Report. Indeed, this will strengthen the attractiveness of SME Growth Markets for companies' first listing, as eligible future issuers can benefit from the Prospectus Regulation's alleviated requirements in respect of public offers they undertake at this first stage.

Creation of a 'Transfer Prospectus' (Art. 14)

FESE Members welcome the proposal to establish a less burdensome 'Transfer Prospectus' for SME Growth Market issuers seeking a graduation to the Regulated Market.

We believe that this measure will be beneficial for companies wanting to 'up-list' and will reduce some of the administrative barriers to do so. However, we would like to highlight the fact that a three-year timeframe might be too long, and companies may wish to 'up-list' prior to this. In this regard, we support the draft amendment proposed by the ECON Rapporteur to reduce to two years the period of time for an SME to make the transfer while being able to benefit from the simplified disclosure regime.

We believe this simplified disclosure regime should only be required for companies who have been on a SME Growth Market for at least two years and are raising additional capital as part of their transfer to a regulated market.

In cases where the issuer has been on a Growth Market for at least two years and is wishing to do a technical transfer to a regulated market with no capital increase, we would suggest to policy makers **an alternative solution**. Such companies should not be required to produce this new prospectus as they would already have been disclosing material information to the market while on the Growth Market and there are no additional shares being raised. Therefore, we suggest only a simplified document should be required to be submitted to the market operator and disclosed to the market. The format and the content of the simplified document should be left to the discretion of the market operator.

New deadline to publicly disclose managers' transactions (Art. 19 (3))

FESE Members welcome the adoption of a new deadline to publicly disclose managers' transactions. It is important that the two-business day timeline applies from the point the issuer was notified as opposed to when the transaction took place as this will allow sufficient time for issuers to notify the market accordingly.

On this matter, we would like to raise the attention of policy makers on the threshold to which the notification becomes obligatory. We believe that this **threshold**, currently setting a total amount of EUR 5,000 reached within a calendar year (Art. 19 (8) and (9)), **should be raised at European level** and not be left to Member States' discretion.

Limitations to the obligation to produce Insiders' Lists (Art. 18 (6))

We support the intent of the European Commission to alleviate the administrative burden on SME by allowing them to only have to produce lists of a more limited group of people having regular access to inside information ('permanent insiders'). SME Growth Market issuers should be obliged to submit insider lists only upon request by the NCA and issuers should not be obliged to maintain insider lists on an ongoing basis. We believe that the alleviated requirements will strike the right balance between reducing burdens and maintaining market integrity.

Justification of delayed inside information to be made only on request (Art. 17(4))

FESE Members support the proposal made by the Commission to require SME Growth Market issuers to justify a notification of a delay to the relevant NCA only upon request. We believe that this proposal will be beneficial for SME Growth Markets' issuers.

However, while it is positive that explanations will only have to be provided upon the request of the NCA following issuer notification, it is important that the explanations are not required to be too detailed nor overly prescriptive.

Nevertheless, issuers cannot be sure when and how long the competent national authority is able to request additional reasoning afterwards and how extensive they have to reply to the request. Hence, we ask to provide clear guidance in that regard and a detailed standard scheme.

Disclosure of inside information for issuers of bonds only

FESE believes amendments should also be made to MAR Art. 17 to tailor the inside information disclosure requirements for SME Growth Market issuers of bonds with an aim to make them more appropriate to such issuances.

Indeed, the provisions related to inside information was drafted and implemented in MAR with equity markets in mind. **However, such a 'one size fits all' approach does not work for debt markets.** Not only is there a radical difference in secondary market dynamics but we are also not aware of any empirical evidence of material market abuse cases within the debt market which would justify the application of equity appropriate compliance requirements on debt issuers.

Today, these requirements are considered by market professionals as extremely onerous as it gives rise to unnecessary administration and legal costs, particularly by non-EU issuers. As a consequence,

prominent bond issuers have delisted from the EU markets (e.g. Microsoft and Freddie Mac), and advisors are leading both EU and international bonds issuers to seek alternative listings outside of the EU markets, deemed too costly and burdensome.

FESE members believe that more needs to be done to strengthen the attractiveness of EU markets for both the listing of equities and bonds. We believe that disclosure requirements should be tailored to SME Growth Markets bond-only issuers with an aim of reducing unnecessary administrative and legal costs. For example, the test to determine 'significant effect on the prices of financial instruments' is very difficult to apply to the debt market, in contrast to the more liquid equity markets.

More specifically, we recommend narrowing the disclosure requirements by **creating an obligation for them to publish all inside information that would directly influence their ability to meet the repayment obligations of its debt issuances**. This would make SME Growth Markets more attractive for the listing of debt securities to both EU and non-EU issuers. Furthermore, this disclosure is most relevant to the assessment of risk for this product market given that bond listings are usually traded less frequently and investor may be more focused on risk spreading and the monitoring of portfolio diversification (without compromising investor protection).

We therefore suggest that consideration could be given to amending MAR Art 17(1) as follows:

The following paragraph is added:

1. An issuer shall inform the public as soon as possible of inside information which directly concerns that issuer.

The issuer shall ensure that the inside information is made public in a manner which enables fast access and complete, correct and timely assessment of the information by the public and, where applicable, in the officially appointed mechanism referred to in Article 21 of Directive 2004/109/EC of the European Parliament and the Council. The issuer shall not combine the disclosure of inside information to the public with the marketing of its activities. The issuer shall post and maintain on its website for a period of at least five years, all inside information it is required to disclose publicly.

This Article shall apply to issuers who have requested or approved admission of their financial instruments to trading on a Regulated Market in a Member State or, in the case of instruments only traded on an MTF or on an OTF, issuers who have approved trading of their financial instruments on an MTF or an OTF or have requested admission to trading of their financial instruments on an MTF in a Member State.

Where an issuer is an issuer exclusively of debt financial instruments admitted to trading on an SME Growth Market, as defined by Article 4 of Directive 2014/65 EU, this Article applies only in respect of the inside information which directly concerns that issuer's ability to meet the repayment obligations of its debt issuances.

Creation of a European regime for liquidity provision contracts for SME Growth Market equity issuers (Art. 13 (12) and (13))

We welcome the Commission's initiative to propose a measure to increase liquidity and reduce volatility of SME shares. It is important to increase the attractiveness of SME Growth Markets for investors, intermediaries and market operators.

We recognise the usefulness of optional liquidity contracts, which are frequently used in some countries (e.g. France). We see merits in having liquidity contracts recognised as Accepted Market Practices.

Nevertheless, we urge the Commission and regulators to recognise and support the diversity of market making practices in the Member States where markets provide for other solutions as is currently being proposed by the European Parliament.

In supporting this amendment, it is important that the Level II measures specifying the contractual template to be used for liquidity contracts provide sufficient flexibility to the market operator to be able to determine the precise elements of the contract. A restrictive template would limit the benefits issuers and intermediaries would gain from their liquidity provision contracts.

Exemption from the market sounding regime for private placements of bonds with qualified investors (Art. 11 (1) (a))

In principle, we support the goal of these amendments to facilitate the process of identifying potential investors. In particular given that it is intended to replace the current national exemptions, under MAR Accepted Market Practices, which already exempt private placement of bonds from the market sounding rules with an EU framework.

However, we wish to state that for smaller issuers there is normally an outsourcing of these obligations to third parties, as the issuer itself does not have enough resources to comply. Therefore, this would place into question whether the issuer is truly alleviated of these burdens.

Comments to the Delegated Regulation (EU 2017/565) Bringing Technical Adjustments to MiFID II

Definition of an SME debt-only issuer (Art. 77(2))

With regard to the definition of an SME Growth Market non-equity issuer, FESE Members **support the proposal** to include a cumulative issuance criterion not exceeding EUR 50m over a period of 12 months. There should be further clarification on the methods and means of measuring each debt issuance of non-equity issuers on all European SME Growth Market because currently there are no public measures to collect such information easily.

Publication of half yearly financial reports on SME debt-only issuers (Art. 78 (2) (g))

FESE Members support the Commission proposal to give **flexibility to MTF operators** to decide on whether or not to exempt debt issuers from the requirement to publish half-yearly financial reports. This requirement can be burdensome for non-equity issuers while flexibility enables adaptation to what best supports the development of more liquid bond markets in each local market.

Flexibility with regard to have free-float requirement (Art. 78 (2) (j))

FESE Members welcome the Commission's proposals for the market operators to establish the threshold of issuers' free float requirement. It is important to maintain flexibility for the market operator to decide the free-float requirement.

Most growth markets have a free-float requirement in the issuer rules. **These rules may include certain flexibility or margin, in order to accommodate for specific situations or specific issuers** who wish to use the public route to financing in an early stage of growth, when there is no or very limited free-float. For instance, in the Baltic markets, where Nasdaq as a market operator does not even require a free-float. Some companies do a "technical listing" first, without free-float, as a basis for building an investor base, and then they float shares. This enables the companies to do a step-by-step approach to tapping capital markets for financing, a solution which works in the local ecosystems in the Baltic markets. Introducing a

free-float requirement would be counterproductive and even go against the intentions of the Commission's proposal to promote SME Growth Markets.

Additional Measures for Policy Makers to Consider

Overall, we believe that the measures proposed by the European Commission are welcome steps in the right direction and we encourage European as well as national institutions to continue working towards creating the best opportunities for making the SME Growth Markets successful as a place for companies to access capital and create growth.

We would like to take this opportunity to highlight some additional measures for regulators to consider.

Alleviations for investors in SMEs

We believe it is necessary to create alleviations and incentives for investors as well as for issuers. As investing in SMEs is considered to be high-risk business, there are severe restrictions for institutional investors (10% limits and other specific limits for pension funds) which should be reduced to raise investment opportunities and increase the attractiveness on the investor's side. Such a liberalisation of the regulatory limitations for the investments of institutional investors and pension funds would be very beneficial especially for smaller markets which currently, to a large extent, lack institutional investors.

Therefore, FESE fully supports the proposal made the European Parliament to adopt a cross-cutting approach and analyse the various sectorial regulations, e.g. Solvency II, IORPs, etc. that could prevent or limit investing in SMEs by institutional investors. We believe that it is key to have harmonised legislation within the EU Member States to support SMEs investing and to ensure the success of the SME Growth Markets.

Assess the tick size regime of SME Growth Markets

We would encourage regulators to carefully assess the impact of the MiFID II minimum tick size regime on the trading on SME Growth Markets, in particular any effects on the liquidity and spreads of shares.

Consideration to the unintended consequences of equity-related rules being applied to non-equity markets

We would take this opportunity to urge the Commission to assess the impacts of MAR on MTF focused on non-equity, i.e. to tackle the specificities of the non-equity MTF markets (not necessarily SMEs Growth Markets) and (re)assess the impacts that MAR brought since 2016 on those MTFs.