FESE
FEDERATION OF EUROPEAN SECURITIES EXCHANGES

A BLUEPRINT
FOR EUROPEAN CAPITAL MARKETS:

How to Unleash Markets' Potential
to Finance Dynamic
and Sustainable Growth

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I INTRODUCTION

Europe needs to finance investment, create jobs and wealth, **and boost economic growth.** The European Commission estimates the overall investment needs for transport, energy and telecom infrastructures networks of EU importance to amount to **1 trillion EUR for the period up to 2020**[i]. About **6 million European jobs** have been lost because of the financial crisis. While much progress has been made since the peak of the financial crisis[ii], we are far from being on a path of continuous growth. Fostering innovation offers the best opportunity to growth and employment in Europe.

In an environment in which Europe needs to reduce its dependence on bank lending, economic development can only be financed through a greater share of financing from capital markets (which in our terminology includes both public capital markets and private capital markets, from here on to be referred to as **"market-based financing"**). The urgency of developing market-based financing has been recognised at the highest political levels in Europe, and most recently by the **incoming European Commission President in his Political Guidelines for the next European Commission**[iii]**.**

More enterprise financing through capital markets will help Europe achieve higher levels of innovation, risk management, savings mobilisation, wealth distribution and job creation. Market-based financing that serves smaller companies well is especially effective in generating jobs: For every five jobs lost by large companies during the crisis in the four largest EU members, small and mid-sized firms created one new job[iv]. 92% of new jobs are typically created by companies after they list[v].

Yet, Europe's capital markets are far from meeting these needs. The EU's markets are falling in the global ranking, having slid from 2nd place behind the US to 3rd place behind the US and Asia[vi]. Similarly, stock market capitalization is only 75% of the EU GDP, whereas bank credit to the private sector is 104% – almost the reverse of the ratios in the US, 136% and 43%, respectively[vii]. By various indicators, European markets fail to catch up with their peers from the Americas or Asia[viii]. Out of the top 26 IPO markets, only six of them are from the EU (another two from the rest of Europe), and none of them in the top five.[ix] In addition to the negative implications for economic recovery, these are also worrying indicators for **Europe's global economic power.**

How can we meet these challenges? How can we grow the share of market-based financing? What will companies and investors need? How can we develop markets without sacrificing stability and safety? Above all: Do we need a re-orientation or just a tweaking of policies?

Our Vision

As the operators of Europe's Regulated Markets, FESE members have come together to elucidate a **common vision** on how European capital markets can finance Europe's future growth and development and what the policymakers and industry can do to accelerate this growth. As we shall explain in greater detail in this document, we believe that **a fundamental re-orientation of Europe's policies is needed** to serve the original goals of the Single Market better at this current point in time. A re-orientation is critical to achieving the objectives of "Europe 2020", the EU's growth strategy for the current decade. As outlined above, more financing through capital markets helps achieve not just greater amounts of financing but also higher levels of innovation, risk management, savings mobilisation, wealth distribution and job creation – which would serve the Union's 2020 objectives on employment, innovation, education, social inclusion and climate/energy.

In the initial 10-15 years of building the Single Market, the EU concentrated on policies that would foster the **integration** of its national financial sectors in order to create **one united European market** that would be efficient, deep, and competitive (e.g. in the image of the US market). In doing this, a major focus was on reducing the transaction costs of trading of the largest stocks ("blue chips") which, it was assumed, would lower the cost of accessing capital markets (but there was no systematic measurement of the net effects on end-users in the real economy). **Cross-border competition** was the main tool to increase efficiency as experienced by the financial services industry. There was also limited discussion on what impact trading would have on the conditions for **listing** faced by companies, especially smaller ones.

FESE members – which traditionally operated nationally-based exchanges - endorsed the EU's objective of creating a Single Market, and rose to the challenge through greater competitiveness and, in some cases, mergers or partnerships on a regional or transatlantic basis, while also continuing to fulfil their capital raising role in the national economies. Other important changes occurring in the same timeframe – in technology and market structure – also led to more pan-European trading, a greater concentration of broker and other services around blue chips, and a shift of trading and investment away from smaller companies.

The resulting policies have helped increase the efficiency of trading, in particular in the largest companies, and as such have been effective. However, we believe that policies of the future should be underpinned by a new direction, which we summarise around three **high-level principles:**

|1| A greater focus on the end-users of capital markets, ie COMPANIES and INVESTORS, and in particular on the core function of capital markets to finance growth.

The main function of markets is capital raising. Ideas need capital, and capital needs ideas. Markets exist for companies and investors (see Sections 2 and 3 of "Our Policy Recommendations in Detail"). Hence, EU policies must focus on ensuring that capital markets provide companies with better access to capital and investors with diverse, transparent, affordable saving opportunities.

|2| The EU Single Market must be ACCESSIBLE to companies at ALL LEVELS: national, regional and pan-European.

Pan-European market structures can offer greater efficiency through economies of scale and liquidity, and benefit many companies which want to and can access the wider investor pool. For this reason, we must continue to dismantle cross-border obstacles. However, pan-European structures cannot be the only way of accessing the Single Market. Most companies start small, and are most attractive to investors in their immediate regional market. It benefits both innovation and employment when companies can access markets close to home before they reach a bigger scale that would be attractive at the pan-European or global level (see Section 3). Moreover, Europe will remain diverse (in terms of languages,

cultures, accounting and legal systems, economic bases and innovation clusters). Hence, European companies and investors need a combination of large, medium and small financial centres, with corresponding ecosystems, to meet with investors.

|3| **A greater awareness of the importance of the DIVERSITY OF ECOSYSTEMS, and the way they are impacted by the inter-action between listing and trading.**

FESE members have operated successful models of services catering to smaller companies that combine their long experience serving their communities with new creative solutions. However, other institutions (such as small and mid-cap accountants, brokers, advisers, analysts, lawyers, etc.) are also needed to facilitate companies' access at the local and regional levels. However, these services catering to SMEs are disappearing (see Section 3). EU policies can make a difference in preventing a further erosion of the local and regional ecosystems. This requires policies that sustain the full spectrum of institutions serving smaller companies and their investors. For example, trading policies governing tick sizes affect economic incentives, which are vital for smaller brokers; policies determining when smaller shares can be traded on alternative venues affect liquidity, and ultimately the demand from investors. Keeping these ecosystems alive must be the main goal.

In other words, our vision is that of a capital market which exists for issuers and investors above all. It is a capital market in which European issuers of different instruments and investors can meet one another at the level at which they are ready and willing – be it local, regional, pan-European or global. In this vision, all policies are designed to help the capital raising function of markets above all other priorities. In this market, any policy on trading is judged on how it affects the diversity of the financial services that exist to serve companies, other issuers and investors. In our vision, competition and efficiency are put to the service of the end-users of markets - the issuers and investors - while the EU creates the right conditions for national and regional ecosystems to serve their stakeholders and economies.

These three principles will ensure that European capital markets are better adapted to the economic and political needs of Europe and better positioned to propel Europe into global economic leadership. This re-orientation will not only finance economic growth, but also enhance the credibility of the EU vis-à-vis its citizens and distribute the benefits of integration among all citizenry.

Overview of Our Recommendations

How do we make the above-described principles operational? We believe that the EU must take action in five distinct areas:

|1| **Europe must adopt a target for European capital markets' share of financing the economy.**

Capital markets must enable economic growth, and not constrain it. To meet the financing needs of the European economy in terms of long-term investment and employment, our capital markets must be sufficiently deep and diverse – and sufficiently large. The size of Europe's capital markets must be increased in relation to the GDP. An explicit political objective – e.g. "stock market capitalisation to account for 100% by 2020" - could be very useful in creating the momentum around the range of policies needed to increase the supply and demand sides of the market.

|2| **Capital markets must become better at meeting investor needs.**

Investors with different time horizons and risk appetites use markets in different ways. A well-functioning capital market should address all of these needs through a variety of robust financial instruments. Among others, markets must enable investors to plan for the future and provide for pensions: this means good growth potential and safety within their desired risk parameters. A core attribute of meeting investor needs is to be open to all investors and to treat them equally – without any segregation among investors.

All investors should have the ability to access financial markets in an equal way, and be adequately informed in order to decide which instruments best suit their investment needs.

|3| Capital markets must finance all companies.

Financial markets must serve companies both large and small, including those which are dynamic, innovative and growing. Financial markets must finance companies from the core to the periphery from East to West and North to South. Our capital markets must offer smaller companies the option of continuing to grow to a larger size in an independent way. This will boost innovation as well as local and regional employment.

|4| EU capital markets must be accessible to the world and be seen as a model.

The EU is the world's largest multi-jurisdictional economic block, with a single currency and a well-integrated market in products and services. The EU is a model to emulate for many regions of the developing world. The European capital markets must remain open to 3rd countries' investors, issuers, and financial institutions. While avoiding extraterritoriality, Europeans should continue to promote the European regulatory model as best practice around the world whenever appropriate.

|5| EU Capital markets must be well-regulated, transparent, fair, and not reliant on taxpayer money.

Last but not least, market-financed growth must be accompanied by sustainability and safety. Capital markets that provide opportunities to finance issuers are only attractive to investors if they are well regulated and transparent and if systemic risk is properly monitored, just as democracy needs a legal framework to be functional. Hence, our markets must have high levels of market integrity and appropriate measures for safety.

II WHO ARE WE AND WHAT IS OUR ROLE IN THE ECOSYSTEM?

Capital markets play many **beneficial roles** in an economy which are vital to economic growth: In particular, public equity markets have the unique ability to finance risk capital, which is the main source of innovation. Capital markets also allow issuers and others to manage risks (especially in the case of on-exchange derivatives); mobilise savings for households (through direct and indirect investments); distribute the benefits of economic progress among broad parts of the population; and generate long-term employment.

As a sub-set of capital markets, public and open capital markets have a **core function** which is intrinsically linked to **equitable and sustainable growth.** FESE Members operate some **40 exchanges** underpinned by **transparency, liquidity, neutrality, efficiency**, and **safety**. These platforms set independent prices of assets, enable capital raising for large and small companies, ensure efficient allocation of assets, create wealth among broad segments of the population, and fuel sustainable growth. Moreover, FESE is home to some of the world's largest and safest **on-exchange derivative markets**, which enable risk management for a diverse range of enterprises (as well as benefitting households indirectly).This central role gives FESE members both an opportunity and a responsibility to shape the future of European capital markets in the service of economic growth.

The EU has taken many important steps over the last few decades to integrate its financial sector. In the aftermath of the financial crisis, EU authorities focused on bolstering the safety of the sector by addressing the problems revealed by the crisis. Now is the right time to take a comprehensive look at the ability of the EU financial sector, and in particular the capital markets, to deliver on their most important objective: **to finance dynamic and sustainable growth for the European economy.**

In initiating this vision, we are conscious of the fact that our platforms are part of a complex and delicate **ecosystem** of numerous important players – brokers, banks, advisers, analysts, auditors, lawyers, etc. – who must all come together to serve enterprises and households in all the different ways in which

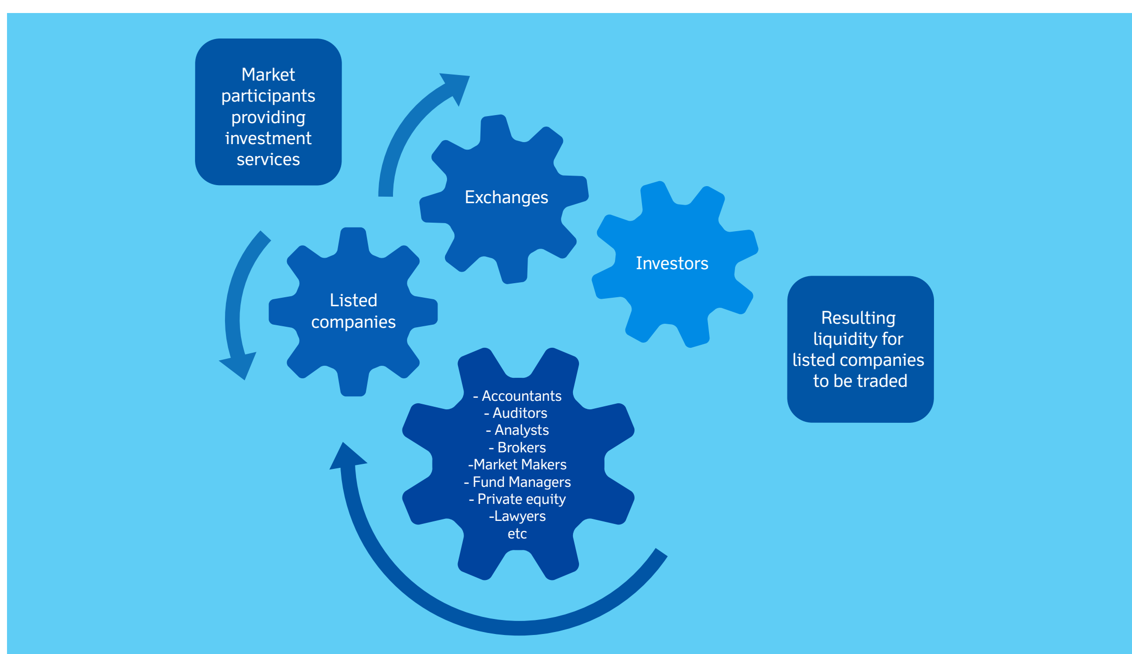


Diagram 1: The European Capital Market Ecosystem

the economy needs capital markets (financing, saving and risk management).

Exchanges are a crucial part of Europe's capital markets. Our member exchanges have long been located in nearly every Member State of the EU[x], and have enabled the **financing of companies** of all sizes through a wide range of instruments (equity, bonds and derivatives) for decades. They operate open public platforms which admit to trading a full range of publicly issued instruments across a wide range of asset classes. The platforms they operate are **neutral**, with no conflicts of interest between the operator and the participants in the outcome of a transaction in secondary markets. These markets are open in the sense that they are **open to all participants** to become trading members of the platform who qualify based on objective criteria set by laws.

Companies access public capital markets run by exchanges in order to reach a large and deep pool of investor funds from all over the world, and draw benefits in terms of low cost of capital, ability to come back to the market successively, brand awareness, funding diversification, and higher public profile. Within the full range of financing options available to companies (including self-finance, family / friends, business angels, bank loans, venture capital, private equity, public capital markets in the form of SME exchanges and Regulated Markets), public capital markets fulfill a unique and complementary role for companies that want to continue to grow independently (as an alternative to a trade sale) and through platforms that provide transparency [xi].

In parallel, **investors** who invest through capital markets draw benefits in terms of access to robust, transparent, well-governed companies, dynamic investments, diversification, and a listing and trading environment that ensures fairness, integrity and equal access. Exchanges also have the "democratic" function of allowing a broad range of shareholders and creditors to benefit from exposure to dynamic investments, while giving investors control over the investments they want to support. Capital markets enable everyone to participate in the financing of the economy and to choose which type of economy they want in the future by choosing the companies in which they want to invest; they ensure that economic wealth (in the form of returns on investment) is not only distributed to a limited number of owners but benefits the broader society by giving each company the ability to access a diversified investor base and each investor the ability to invest in the company of their choice and benefit from this investment.

From an **economic point of view**, the platforms in which exchanges bring investors and companies together result in job growth; greater productivity, efficiency and innovation; regional economic gains due to subsidiary activities supported; and associated tax revenues. Moreover, because of the transparent listing and trading principles underpinning the exchange model, the economy gains in terms of greater stability, safety, fairness, and reduction of systemic risks.

One of the most critical functions of an exchange is **price formation**. Exchanges provide the open and efficient interaction of the demand and supply for their financial instruments which the rest of the economy uses for a number of crucial purposes. Public markets stand for consistent and comparable reference and price data across Europe. Public markets are much more robust in volatile times in terms of continuing to supply correct asset price information to the real economy, as evidenced in the financial crisis. Multilateral, open, transparent market interactions deliver purer and more robust signals. Price formation in a multi-venue environment requires the interaction of all orders in a streamlined way with no segregation, transparency of trading, transparency of company information, equal access for all participants, robust systems, and supervision, all of which are critical elements of the public trading platforms run by our members.

Separately, **risk management** enabled by on-exchange derivatives plays a key role in the economy. Exchanges have developed tools for investors and companies to diversify their investment/ funding and hedging opportunities. In particular, exchange-traded derivatives are a valuable hedging instrument for the real economy, allowing companies and investors to manage risks and improve the safety of markets overall.

Finally, it must be noted that the **trading system** affects the end-users only indirectly. Over the last decade and a half, trading has become more complex, while trading costs have come down. However, companies and investors may not necessarily be better off with marginally lower trading costs, since what really affects their interests is not the transaction cost of trading but the cost of capital and savings possibilities. It is for this reason that any policies that affect the ecosystem negatively – even if they help improve the efficiency or returns for certain players of the financial sector industry itself – may not be beneficial for the real economy.

III OUR POLICY RECOMMENDATIONS IN DETAIL

1. Investing in economic growth – Adopting a Target for European Capital Market Financing

FESE strongly believes that **Europe must have a target for how much of its financing – in relative terms to other macroeconomic variables - should ideally come from markets.** Growing the size of European capital markets will require a concerted effort by all industry participants to develop a range of market and regulatory initiatives. While it would be difficult for the share of European market-financing to resemble that of the US in a few years, it is clear that we need to set the ambition of reaching the level of effectiveness of the US markets in financing the US economy. This will allow European capital markets to meet more of the needs of the economy (in a sustainable and safe way) in the face of banking sector reforms that will continue to constrain banks' ability to fund our economies.

A goal formulated in concrete terms would serve to focus the minds and gather momentum. This goal can be set in terms of 2020 (linking it with Europe 2020) or 2025 (setting the goal for the coming decade). We would suggest a goal such as **"stock market capitalization to reach 100% of EU GDP by 2020.**

In this context, FESE and its Members have played a central role in the establishment of the **European IPO Task Force** [xii], alongside EuropeanIssuers and EVCA. It will develop concrete recommendations in respect of how capital markets can best serve all companies and investors in particular by increasing the pipeline of companies coming to the market. Policy recommendations will be made in the autumn of 2014.

Mind the Gap

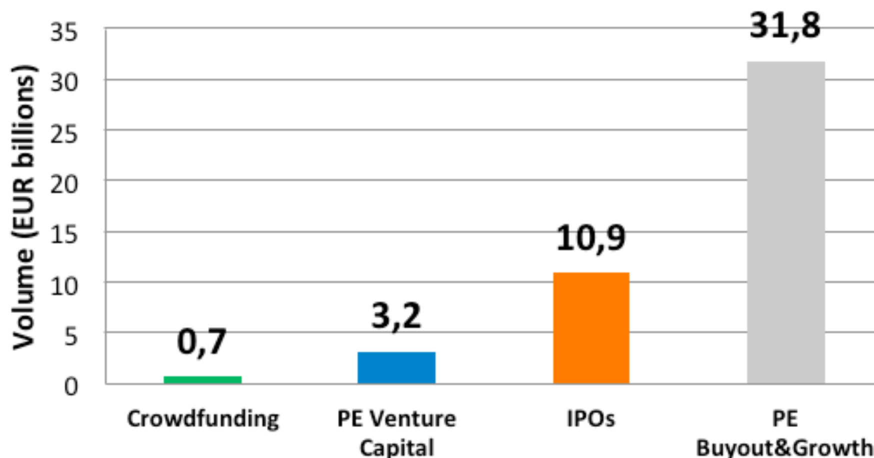
Below we provide further details on the different parts of the capital markets that must grow.

European Equities' Markets:

There is a big potential to increase the share of market-based financing in the economy in the service of growth. As of 2013, the stock market capitalization was only 75% of the EU GDP, whereas bank credit to the private sector was 104% - more than double of the bank financing in the US, which was only 43% [xiii].

Europe needs to set itself the ambition of significantly increasing the **size of capital market financing of enterprises** in relative terms to GDP.

Currently, 11 thousand European SMEs (out of 23 million total) are already accessing capital markets. About 4,5 million individual investors and savers are accessing markets today (the potential is much larger as 43% of financial assets are held by households).[xiv] 10 trillion EUR of assets are managed by European investment



funds[xv]. As populations age, demand from European investors for equity between 2010-2020 is expected to fall short of the supply of equity by issuers by 2 trillion EUR [xvi].

Chart 1 shows the different sources of non-bank funding available to enterprises. While each of these market segments is important, globally, they are small when compared with the needs of the economy.

European Bond Markets:

Turning from equity markets to **bond markets** – comprising of investment grade and non-investment grade companies – here too we see that European bond markets are relatively under-developed and less liquid and less broad than their US counterparts. Bond markets are an important alternative to bank credit. They are important for infrastructure/project bond investing.

In 2011, the volume of the US corporate bond market in 2011 amounted to 35 percent of GDP, with Japan (17 percent), and the EU average (15 percent) lagging behind. However, if we consider developments between 2005 and 2011, Europe as a whole appears to be catching up. In fact, European bond markets have grown quite extensively since around 2000, in particular in the euro area. Bond market size generally appears relatively robust under the financial market turmoil[xvii]. While these trends are welcome, EU bond markets must continue to develop further.

Corporate bond markets are being radically changed by a confluence of factors – e.g. new Basel III capital and liquidity rules, the MiFID II requirements on transparency in bond markets, and the availability of innovative new platforms based on equity and FX market technology[xviii].

We also wish to note the need for a more liquid market to ensure that a liquid benchmark can be created to price bonds off. Given capital constrains on holding bond inventory, there is a need for a market where liquidity can develop in a transparent, public market rather than only between the dealers.

There has been a debate about European bond markets and the appropriateness of the entire infrastructure, in particular for the trading of European sovereign bonds, and how to improve transparency without adversely affecting liquidity and efficiency. The crisis has shown that transparency is a vital element of well-functioning markets, even and perhaps especially during periods of stress. This has challenged previously existing assumptions about the usefulness of transparency in the bond markets. Just like equity markets, FESE supports that bond markets should also be subject to transparency rules, with appropriate exemptions and delayed reporting mechanisms as are provided in equity markets. This would solve a number of market imperfections and increase the proportion of market activity that is conducted in a transparent way.

Bond trading is mainly executed on an OTC basis via electronic platforms or via telephone brokerage platforms. It is estimated that about 95% of bond trading is OTC out of which telephone brokerage represents the larger part of the OTC market and only 5% is executed on either RMs or MTFs. Based on our experience, we believe that properly calibrated pre- and post-trade transparency regimes should apply which will benefit all market participants, in particular investors, and we therefore welcome the MiFID II regime.

The trading of bonds is only transparent on RMs because RMs provide transparency for all the products they trade, which leads to a more efficient price formation process by distributing price signals more rapidly to the market. Pre trade transparency also promotes liquidity because it ensures comparable access to information for all market players and it lowers transaction costs (e.g. lower spreads due to increasing competition between market makers). One of the main functions of post-trade transparency is to boost trading interest by helping investor confidence. In addition, it also helps in ensuring and monitoring best execution obligations. Extending mandatory post-trade transparency to all types of bond instruments would provide the same benefits present in equity markets and would allow ensuring best execution, which applies also to bond instruments.

Finally, for the bond markets to mirror the success of, for example, the US private placement market, the ecosystem needs to be developed in a meaningful way. Such a development would be particularly important for SMEs as they look for a substitute for bank funding.

European Derivative Markets:

Derivative markets play a crucial role in financing the economy. Europe is home to some of the world's largest and safest on-exchange derivative markets, which enable the risk management for a diverse range of enterprises as well as investors. As the crisis has shown, on-exchange derivatives are very positive for the economy. For many decades, derivatives of various kinds have played a very positive role in the world economy. FESE fully supports any policy initiatives taken to address market deficiencies unveiled by the financial crisis which should target improving the safety and integrity of derivatives trading and clearing while maintaining their positive contribution to the economy and the financial sector.

FESE members play an important role in the global derivatives market. They operate well-regulated, transparent, technologically advanced trading (and in some cases clearing) arrangements with a proven value proposition and track record in safety and reliability. It is the wish of derivatives exchanges to maintain the highest standards of safety and integrity, as well as efficiency and competitiveness, in the trading of derivatives in a global marketplace. Regulated markets ensure that all derivatives trades are cleared through central counterparties. As was the case for fixed income, the crisis has shown that transparency is a vital element of well-functioning derivative markets, even and perhaps especially during periods of stress. On-exchange trading has been proven to perform in extreme conditions like the recent financial turmoil, when the Lehman Brothers' outstanding positions where closed out within hours. Trading via regulated exchanges cleared into central counterparties mitigate counterparty risk, increase liquidity, allow for sound margining and risk control requirements over clearing house members, increase transparency on open risk positions and provide records on OTC derivative transactions. In addition they offer greater risk reduction benefits, particularly in terms of increased liquidity in moments of stress in OTC markets.

Hence, OTC derivatives have been put on a path of standardisation and clearing to ensure that derivative markets as a whole pay a positive role. In this sense, the size of derivative markets in Europe is generally satisfactory when measured against the needs of the economy, but the share of on-exchange vs OTC should (and will) increase as a result of the policy changes in motion.

Increasing the overall pie of market-based financing:

In summing up the problems described above, it is important to stress that **we need not less bank financing but more market financing**. Banks are a crucial part of the ecosystem, and there are lots of positive interactions between banks and markets. Banks have unique advantages (proximity to client, originating the loan) – and markets have unique advantages (multilateral risk financing, transparency, neutrality): the system needs both banks and markets. Importantly, while banks can also provide risk financing, this is bilateral, whereas markets give access to a broad pool of investors who undertake risk financing based on transparent data. Bank lending will continue to remain an important form of financing but will increasingly need to be complemented by other sources, in particular public capital markets.

An example of complementary financing is **securitisation.** As described in the Communication on Long-term financing of the European economy, securitisation can be an important force in helping smaller loans gain scale and benefit from capital market financing. However, **securitisation is not a substitute for direct financing of investments by capital markets**. Direct public market financing brings many unique advantages– such as collective investor wisdom, increasing economic growth opportunities, an economic growth model that is chosen by individual investors and a model in which the benefits of growth benefit the whole society. Both indirect and direct ways of accessing capital markets must supplement banking, which has been the prevalent form of financing the economy so far.

Finally, another important factor in which the financial markets currently fall short of our vision is the fact that **the ratio of equity vs debt** is not optimal. While we use the word "optimal" with caution, it is clear that the equity part of the market is suppressed artificially by

fiscal advantages given to debt instruments, especially in the aftermath of the sovereign crisis. This bias against equity in corporate taxation in particular has been recognised in the recent Commission Communication, which states that the Commission will monitor the issue "through country specific recommendations in the European semester process, to incentivise equity investment in particular for Member States with high debt bias in corporate taxation." [xix]

Policy Recommendations: Investing in economic growth - Adopting a Target for European Capital Market Financing

Below we give more detail on how to grow the size of capital markets in the economy:

Setting a goal for the growth and development of capital markets

For capital markets to fill the funding gap and providing for greater levels of growth, we need a significant growth of capital markets beyond current levels. While the bank-to-market ratio depends on a number of different structural and macroeconomic factors, our belief is that **Europe must have a target for how much of its financing – in relative terms to other macroeconomic variables- should ideally come from markets by 2020 or 2025**. Hence, European authorities must set themselves a political target of market-based growth that is achievable while ambitious. Having a goal will focus the minds and propel further action towards this objective. This objective can be set in terms of market capitalization as a percentage of GDP or the share of enterprise funding that comes from markets.

We would suggest a goal such as **"stock market capitalization to reach 100% of EU GDP by 2020.**

Removing and avoiding disincentives for investors

We need to orient more investor flows into listed equity, bond and derivative instruments by **avoiding** any new or existing tax and regulatory **disincentives** that suppress investor demand (and, in selective cases, by considering whether to provide potential well-designed tax incentives). Hence, we welcome the various steps announced in the Long-term Financing Communication concerning, for example, the Level 2 measures for Solvency II for infrastructure, SMEs and social businesses. Moreover, any new tax policy (including proposals such as the Financial Transaction Tax) which would discourage investors from investing in capital markets, in particular in listed instruments, should be avoided. Setting in place the right regulatory and tax environment will lead to a bigger "demand" side for capital markets.

Developing a "capital market culture"

On the demand side, in addition to incentives, more investors must be able and willing to invest in markets. Financial consumer education plays a key role in encouraging more investors to invest in capital markets. Europe lags behind particularly in the share of investors invested in the equity and non-equity markets when compared with the US, in which the public opinion for capital markets remains positively associated with entrepreneurial dynamism. This contrasts with Europe, which is relatively conservative vis-à-vis the use of markets. Public-private cooperation in the area of education would be useful. Promotion of markets of course must go hand in hand with measures to re-build and sustain confidence in markets (which will be discussed in greater detail in Sections 2 and 5).

Improving the attractiveness of listing by focusing company disclosure on clear goals of investor protection and market integrity

Increasing the size of markets in general requires increasing the "supply" side of the market by making listing more attractive. As will be explained in greater detail in Section 3, disclosure rules for companies play a big role in determining the number of companies that want to use capital markets, especially public capital markets. Hence, rules that do not serve an immediate investor protection or market integrity purpose should be re-assessed to reduce the cost on issuers.

Providing neutrality in the choice between equity and bond financing

Finally, in addition to growing the demand and supply of capital, **the share of equity financing in overall markets (when compared with bonds) needs to be boosted**. For this, we need neutral tax / regulatory incentives that should leave investors and companies free to determine the instrument that suits their needs the best. By contrast, there is a bond bias that has tilted investor and company behaviour in favour of bonds. Several recent studies have looked at best national practices from across Europe which must be studied and shared.[xx] These incentives should be in addition to the Commission's work on trying to reduce/eliminate the corporate tax biases against equity.

2. Serving all investors

As outlined earlier, capital markets have two key end-users: investors and companies. Taking the former first, we would like to outline a number of improvements in the way markets serve investors in Europe.

Mind the Gap

In our view, investors need a choice of well-regulated instruments, diversity of ways of accessing markets, and transparency about the products and the services they get, in a cost effective manner. European capital markets need to improve in order to deliver towards these objectives, as explained below.[xxi]

Active vs passive investment:

In our view, markets need to **enable a greater degree of active investment in Europe**[xxii] Due to a number of structural reasons (intermediation, benchmarking, etc), the correlation in the performance of assets in non-volatile times has become stronger. Hence, statistically, it has become very difficult to beat the index, which encourages passive investment strategies. At the same time, changes in ownership structures and greater intermediation have made it more difficult for shareholders and creditors to exercise their rights actively. In our view, the issue is not one of absolute levels but of balance. Both active and passive strategies of investment have their unique advantages for their users, but their uses should be more balanced and both should be available to investors.

According to the OECD,[xxii] over the last few decades, European markets have become dominated by institutional investors who invest passively. *"Over the last 50 years, the ownership structure of listed companies in most OECD markets has moved from direct ownership to intermediary ownership. The increase of intermediary ownership has for a long time been coupled with a rise of passive investment strategies that are based on a closely pre-defined set of criteria."* The OECD report discusses the various implications of these structural changes, and notes that they could, under certain circumstances, **undermine the markets' fundamental function of allocating capital efficiently in the economy.** Put simply, for markets to allocate capital efficiently, we need more investors who make conscious investment decisions. This will also address the classic principal-agent problem between the companies and shareholders by ensuring that owners of a company have an adequate say in in the way it is managed.

Complexity of markets :

The broader context of this problem is the **greater complexity of markets**. As the Kay Review[xxiv] has concluded, the chain of intermediaries standing between investors and their investment has become too long. Greater complexity of markets creates many problems in addition to high proportion of passive investment. Not only does excessive complexity reduce the ability of investors to invest actively or to evaluate the risk they are taking, it also increases the cost of accessing markets. Incidentally, this also makes it more difficult for retail investors (who tend to be active investors) to access the markets directly.

Retail access:

A linked question is **how retail investors can access markets.** Retail investors often complain about their "dis-intermediation" from capital markets and the fact that they are forced to purchase packaged products instead of being able to invest directly in the markets[xxvi] Currently competition in the execution-only brokerage market in many countries is rather limited; the access to non-domestic securities is often more difficult and expensive and the service faces some regulatory constraints in some jurisdictions. Direct market access in Europe still needs to improve further; T2S should be used as a tool to offer all European retail investors access to the entire European security offering in a cost-effective way. Standardisation of products plays an important role in retail investor access.

Costs:

A related point concerns the **costs borne by end-users of capital markets, i.e. investors and companies**. The EU's Financial Services Action Plan has been built on too narrow a focus on the costs borne by intermediaries. As a result, the EU policymakers do not have the tools to measure and assess over time the costs borne by the end-users.

Pension funds:

Finally, **pension fund investments in capital markets need to grow** to meet the additional demands put on the system by the aging population and to help finance long-term growth. Pension funds invest in both publicly and privately issued instruments. Globally, 56% of large pension fund assets are in fixed income and cash, 28% are in equity, and 16% are in alternative investments. It is noteworthy that, in some markets, a much smaller share of pension funds are invested in capital markets than the average.[xxviii] In certain countries, pension fund investments have gone down significantly with the crisis (eg in the UK). This not only limits the funds available for companies, it also potentially reduces the earnings for pensioners in the long term. Looking at the fixed income share of pension assets, it must be noted that pension funds buy a significant amount of sovereign debt, which crowds out investment in public equity and public corporate debt. Hence, they must be able to invest more in corporate (non-sovereign) debt and equity.

Policy Recommendations : Serving all investors

Increasing active investment

- For the sake of stability and dynamism, Europe should seek a **greater balance of active and passive investment**, so that the market is not predominantly composed of passive, but also of active investors (in addition to having a mixture of investment horizons);
- We need more rewards **for institutional investors** who make active trading and shareholding decisions. However, this goal should target increasing fundamental risk-taking, which is core to the functioning of markets. For example, hedge funds, which may not traditionally be seen as active investors and rather as speculators, are actually very effective in risk-taking which helps the economy because of the way in which they manage risks by off-loading certain risks and then choosing to invest in other risks;
- To help **increase active investment**, and to improve investor access, we need a **streamlined and simplified process for corporate governance**, in which intermediaries inform investors adequately and enable them to participate in decision-making in companies.

Reducing the complexity of markets

- We should **avoid unnecessary complexity when meeting investor needs**. This not only means reducing the complexity of the intermediation chain, but also **avoiding unnecessary complexity in trading.** The US, which has a market structure that is generally accepted as being too complex, is on a path to review its structure to reduce this complexity. While we have so far avoided the same level of complexity in Europe, many investors complain that transparency has decreased and cost of complexity has increased after the introduction of MiFiD I. The way MiFID II is implemented will determine the evolution of our markets to a large extent. For example, the regulation of best execution in Europe is superior to the US approach because it minimises complexity while meeting the diversity of investor needs. However, the best execution policies need to be transparent and enforceable.

Reinforcing direct retail access

- We believe that **retail investors should not only be able to invest in managed funds but also directly**.[xxix] They should be allowed to have a more direct access to the markets, with nonetheless the need for an equilibrium between the participation of retail and institutional investors considering the 'stabilising' role of the latter on the markets. Hence, we believe **Europe needs to keep the markets for e-brokerage open and to ensure access to all European securities**. With the greater computerisation of the households, e-brokerage creates opportunities by adding to the diversity of methods for investing. In parallel, all Europeans should have access to all publicly traded securities in a cost-effective way.

- **Retail investors should also have access to the primary bond markets** (they are only active in the secondary bond markets today, which is due to the distribution channels). However, this has to be weighed against the greater risks for retail investors, since bonds are more heterogeneous, and there is a downside to retail investor participation in these markets.
- More generally, efforts to increase greater direct retail participation have to be **balanced against the need of investor protection**. While we call for greater possibilities for retail investors to access capital markets directly, we recommend caution against exposing retail investors to risks which they are not well-placed to assess.

Reducing costs for end-users

- **Markets must be as low cost as possible for investors**. As noted, the FSAP has focused too much on trading costs borne by intermediaries; in our view, the full cost chain must be taken into account (from intermediation costs to settlement) as well as implicit costs (market quality metrics such as execution price, spread and market depth demonstrating that open, multilateral markets overall have a better market quality, and hence lower implicit costs)
- The costs for end-users should be the focus, not that for intermediaries. This will allow not only a better design of policies that benefit all **end-users** but also the assessment of the existing policies for improvement.

Giving pension funds a greater role in markets

- We need a **neutral regulatory treatment** towards public equity and bond markets, especially in the context of **pension funds**. EU governments changed rules on pension funds to favour government bonds but now that the crisis is subsiding, these rules need to be changed back. Europe needs to go back to a normal level of pension fund investment in sovereign debt.
- In parallel, we need pension fund policies that are **not biased** either towards bonds or equity. Historically, equities outperform bonds over the longer term. Given the longer-term horizon of pension funds, making just a small portion of funds available to, for example, SME financing could trigger a huge potential for innovation and growth while adding substantial performance opportunities to investors.
- Finally, in the context of a growing use of defined contribution systems, it is better for clients to have greater control over their asset allocation. Use of public markets actively would thus empower the pensioners.

3. Serving all companies

When markets finance companies, the economy gains jobs. As an example, the US economy might have produced up to between **6 and 19 million more jobs over the last two decades** if its IPOs had kept pace with GDP growth.[xxx] This is consistent with a major US study that showed that 92% of the new jobs created by companies come after becoming public.[xxxi] As the world's biggest economic bloc, the EU could greatly benefit from job growth on a similar scale.

Job creation is strongest among the so-called "mid-cap" companies which are or could be listed on exchanges. While SMEs of different sizes overall have a large share of the EU economy, [xxxii] the largest SMEs have a disproportionately important share of job growth. In particular, a study by the ESSEC Business School and GE Capital, [xxxiii] covering France, Germany, Italy and the UK for the period of 2007 to 2010, showed that, while the mid-sized companies represent a tiny fraction of total companies – ranging from a low of 1.2% in Germany to 1.7% in France – they generate about **one third of private sector revenue and employ about a third of each country's workforce.** The study stated that, combined, the middle market in these four European countries listed above contributes €1.11 trillion ($1.48 trillion) to their GDPs, noting that this "makes the middle market in the EU-4 one of the top 10 economies in the world, ahead of India and Russia". [xxxiv] The study shows that mid-caps created 280,000 new jobs, while large companies in Europe lost almost 1.5 million jobs in the same timeframe. [xxxv]

Hence, **the larger SMEs** – which are the ones most likely to seek market-based funding as opposed to bank credit - **are exactly the ones that have the highest job contribution to the economy.** Put simply, if more SMEs - in particular larger ones - were able to grow through capital markets, we could recover pre-crisis employment levels.

Moreover, as with companies of all sizes, listing has other unique advantages for the listed SMEs and for the broader economy. Listing on exchange gives the SMEs recognition and visibility and allows shareholders or bondholders to benefit from the performance of dynamic and innovative companies on their way to growth. Furthermore, listed equity or debt provide SMEs with stable, long-term financing, provide information about the value of the company, make SMEs more attractive for venture capitalists, and improve the governance of companies. [xxxvi]

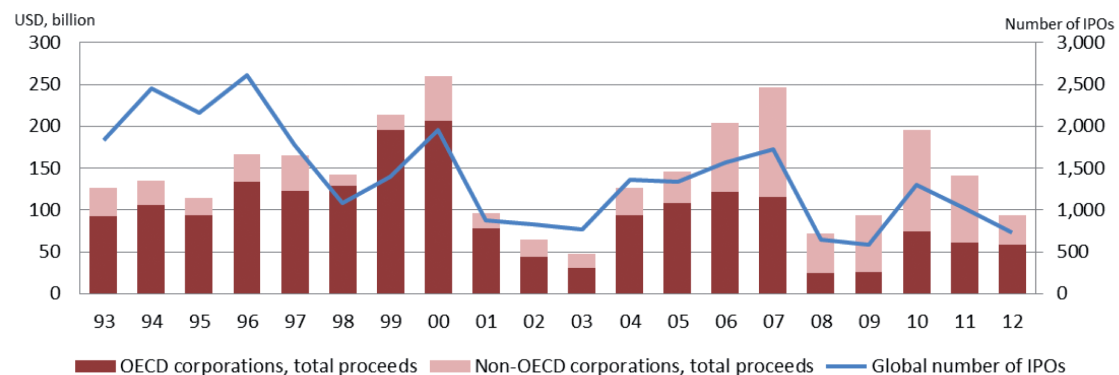
Mind the Gap

How good are our markets in meeting companies' needs?

IPO Markets in general:

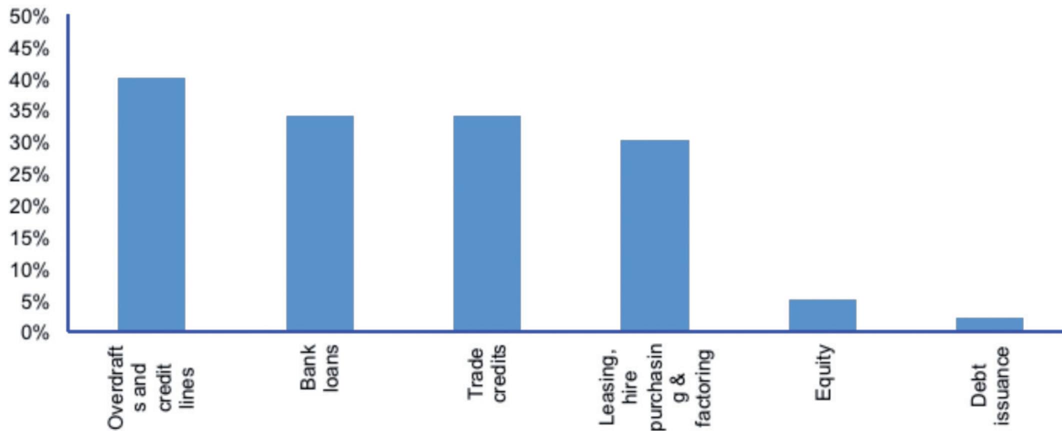
Recent evidence from the OECD [xxxvii] shows that **IPOs around the world, and in Europe, show a systematic long-term downward trend (please see Chart 2)**. While the recent

Chart 2: Global IPO Trends Since the 1990s
(taken from page 12 from Isaksson, M. and S. Çelik (2013), "Who Cares? Corporate Governance in Today's Equity Markets", in 2012 USD, billions)



Source: Based on data from Thomson Reuters New Issues Database, Datastream, stock exchanges' and companies' websites.

Chart 3: European SME financing sources (sample survey)
2009 – 2012, % of SMEs using source in last six months.



Source: Oliver Wyman

recovery in the IPO market covered in the media is promising, the longer term trends show that, beyond cyclical factors, fewer companies are coming to public capital markets, they are raising less capital in total – especially in relative terms to GDP – and the markets are less accessible to smaller companies. Hence, **by all measures that matter, IPO markets are contracting in the long run.**

According to a report commissioned by the OECD,[xxxviii] **the world is producing only a third of the IPOs it generated per year in the 1990s**. [xxxix] While Asia is doing better than other regions, it is not enough to pull the world out of a widespread enterprise funding crisis. US stock markets have experienced 15 years of consecutive listing losses from 1997 to 2012. [xl] European initial public offerings by new companies are among the worst hit, especially when compared with European GDPs. Throughout 2008-2012, only 6 [xli] out of the top 26 IPO markets were from the EU, and they produced fewer IPOs than Australia and Canada put together. By contrast, Asian countries produced 3 times as many IPOs in the same period. [xlii]

Financing of Smaller Companies:

A recent Oliver Wyman study [xliii] notes that there is a major funding gap for SMEs worldwide amounting to 1.5 trillion USD. The study also notes that capital markets could contribute to closing the SME financing gap by 5-10% and thus making a significant contribution to world GDP. However, the study notes, this requires a major set of reforms to improve SMEs' access to capital markets.

In a similar vein, the OECD-commissioned report by Weild et al notes that the share of small companies (below 50 million USD market capitalisation) among all listed companies in the US has dramatically decreased from 80% to 20% over the last 20 years. [xliv]

In Europe, the share of similarly sized companies (defined as below 50 million USD) is currently 51% of the total listed companies, while another 16% are between 50 and 150 million EUR and 19% are between 150 million EUR and 1 billion EUR. [xlv] SMEs access capital markets via shares or bonds admitted to trading on the main market (Regulated Markets) or on junior markets (MTFs). Of the 23 million SMEs in Europe , 11,370 companies are admitted to trading on exchanges. [xlvii]

In the Oliver Wyman study, data is presented on the share of financing sources used by SMEs in Europe on a sample basis. Please see Chart 3 below. While the authors show that only 5% of SMEs in Europe issued tradable equity and 2% issued debt, **up to 20% of SME funding could be sourced from the capital markets.**

It is one of the strengths of the EU market that a small company has traditionally been able to access capital markets, which is why their share in market capitalisation is relatively

high. However, the share of smaller companies in the new IPOs (ie, the flow of new companies entering markets) shows a downward trend in many countries. This means that smaller companies are finding it increasingly difficult to access European IPO markets. In our view, the long-term decline of IPO activity in Europe has been fuelled and driven by a fundamental weakening of the overall ecosystem, which is disproportionately more important for SMEs and midcaps.

This problem is also confirmed by a recent report by the **ESMA Securities and Markets Stakeholder Group of the European Securities and Markets Authority** (SMSG) [xlviii], which states that *'MiFID has also heightened the pressures faced by small and medium sized intermediaries with respect to their cost base. The latter were traditionally providing research activities and listing services to the SME sector. A decrease in the amount of research available for SMEs has negatively affected the liquidity of these shares on public markets'.*

The report concluded that regulatory initiatives had a negative impact on the ability of SMEs to access funding. Moreover, the minimum market capitalisation at which a company can go public has increased significantly and primary markets are perceived to be open only to large sizes or specific sectoral niches. Due to the new regulatory requirements – Basel III and Solvency II - which have their own merits, banks and brokers are focusing their efforts on the most profitable (larger) companies, thus restricting the access of SMEs to funding. Today, mid-market companies in many countries struggle to find brokers able to help them with the IPO and analysts to cover their stock. For the same reasons, brokers making markets in less liquid stock are few and disappearing – thus making listed SMEs less liquid and more costly to maintain listing. An additional disadvantage is the lack of harmonisation of national accounting rules and taxation base that make it costly for companies to produce a set of national accounting as well as IFRS if they want to access capital markets. For investors, this limits the comparability of companies and makes analysis more complex.

This is also the experience of European Exchanges. While all Exchanges perform a wide range of commercial activities to promote IPOs, structural **factors** are making it increasingly difficult for companies to access public capital markets.

As explained earlier, a number of regulatory and technological changes over the last decade have led indirectly to a **greater market focus on the blue chips at the expense of smaller caps.** This is a globally observed phenomenon, some reasons behind which are shared, some more local. In the US, the low tick sizes are generally seen as a major reason behind the erosion of the ecosystem for listing SMEs, since they have dramatically attacked the business models of the mid-cap brokers. This is why a new pilot project of larger tick sizes for smaller caps is being introduced in the US.[xlix] Other structural reasons cited as reasons behind the erosion of the US ecosystem serving smaller caps includes the changes to the disclosure of information to investors, corporate governance rules, the research settlement , and the increasing predominance of trading over investing. [lii]

In Europe, the policy drive to create the EU Single Market – in itself a laudable goal – exacerbated other technological or market structure factors that together shifted the focus of markets from capital raising to trading, and a search for higher efficiencies in trading that came at the expense of the markets' capital raising function. While many commentators welcome increased efficiency in blue chip trading - which accounts for most of the traded volumes, but only for 14% of all listed companies[liii]- others rightly worry about the unintentional **decimation of the mid-market ecosystem** which traditionally supported and innovated around European mid and micro-cap stocks. We must now turn our focus to the needs of the much more numerous but smaller listed companies that play a critical role in growth and employment in Europe.

In particular, we are concerned about the **disappearance of actors active in the local capital markets – brokers, analysts, advisors, exchange operators – who have suffered from the impact of diminishing liquidity at the local level.** These changes have made it more difficult not only for the local capital markets to sustain existing smaller listed companies, but for the great majority of unlisted companies to consider accessing capital markets. Hence,

integration has inadvertently undermined the less profitable, but socially valuable functions of capital markets, i.e. the financing of smaller companies at the local level.

Europe needs to act now to enhance the ability of its IPO markets to finance growing and dynamic companies. Structural constraints – above all the disappearance of the **local ecosystems** – are holding back IPOs around the world.

There has to be a **vibrant ecosystem** at each level (national, regional, European, international) at which companies may wish to access markets, and not just a concentration of professional services for issuers at the European level/for blue chips.

In parallel, we need to help SMEs to access pan-European investors by making them **more visible as an asset class** and by increasing the scale of investment through fund-of-fund solutions.

Finally, capital markets must continue to provide **key benefits** to companies other than capital raising (in particular hedging against risks).

Policy Recommendations: serving all companies

Enabling companies to raise capital at their own preferred scale

- For the larger companies, the EU Single Market – which allows horizontal integration of investor pools across Europe - increases the amount of capital available and reduces the cost of capital. However, not all companies can access the market at the pan-European level. Creative solutions are needed to allow smaller companies to benefit from the pan-European marketplace. In practice, companies all start small, and small companies need a mix of markets – local, regional, and pan-European – to meet their needs. While certain smaller companies – eg high-tech ones – might find it easy to access not only pan-European, but global capital markets, other growing companies stand the best chance of entering capital markets in their local environment before moving on to regional or global markets (if they so choose).
- Hence, as a general principle, Europe must provide **multiple levels of access for the Single Market:** We need a mix of **ecosystems** of different sizes to serve companies. Capital markets must be accessible at the **local level** for those companies which want to access markets locally, while also providing **regional** or **pan-European** access for those who can/want to access markets at those levels.

Addressing the erosion of local ecosystems – what the industry can do

- The need to re-build local ecosystems (ie brokers, auditors, analysts, lawyers, etc) was recently noted in a report by the **EFC's High Level Expert Group**, which called on Member States to "investigate (and report on) as a matter of urgency what is required in their market to (re)build an ecosystem comprised of dedicated analysts, brokers, market makers, ratings etc., that can both advise and support issuers and investors, and foster the liquidity of equity growth markets. This will aid in the development of small and mid-cap financing through equity growth markets and will also support the private placement mechanism which relies on the same ecosystem."
- Just how this can be done requires further study and coordination at the national and European levels. Creative solutions to reinforce the local ecosystems are one of the main topics of study by the **IPO Task Force** established by FESE, EVCA and EuropeanIssuers and with recommendations expected in the autumn of 2014. This initiative was referred to in the recent Commission Communication.[liv]
- Some of the actions required to re-build local ecosystems can be taken by the industry itself and therefore do not need policy action. For example, we as FESE members see potential benefit in some of the ideas below which have been put forward in different fora:
  - The Oliver Wyman study[lv] suggests that exchanges can "connect SMEs

to different types of investors (such as angle investors, VC and private equity) and help them gain access to ancillary professional services [which] could include stakeholder coordination and management, due diligence and prospectus writing, investment case development, IPO roadshow support and financial PR and marketing services." The same study also states that "exchanges can connect companies to professional services such as accountants and legal advisors." Many exchanges already provide such a network for going and being public.Again the same study suggests common action among exchanges in the form a "virtual board" to allow smaller companies access to regional or pan-European investor *base*.

- These are only some examples of ideas that can be pursued by exchanges and others in the industry to fill the gap left by the erosion of the local ecosystems. In particular, we will be reviewing the conclusions of the IPO Task Force later in 2014 to put in motion a suggested action list for the industry.

Addressing the erosion of local ecosystems – what policymakers can do

- As a complement to the industry's actions, the re-building of ecosystems can be supported by policy/regulatory initiatives, such as the following:
  - ***Tick size regime:*** All features of the market that affect the economic incentives for intermediaries affect the ecosystem by incentivising or dis-incentivising brokers and markets makers to engage in the mid-cap market. Hence, features of the trading system such as tick sizes must be designed with the SMEs in mind. Tick sizes for SMEs need to have a different model than blue chips. In Europe (contrary to the US), the level of tick sizes for smaller shares have not yet become the subject of any substantive debate in terms of their impact on the incentives for bringing mid-caps to the market. We believe that this should change. The OECD-commissionedliv report shows that tick sizes in Europe are among the lowest in the world and therefore could pose a problem for smaller shares. In the context of ESMA's ongoing work to implement MiFID II, particular attention should be paid to whether tick sizes for smaller caps are generally satisfactory, and whether they should be increased (as is currently being done in the US).
  - ***Trading methods to improve the liquidity of smaller shares:*** Lower liquidity of listed SMEs dampens incentives for all parts of the ecosystem (as well as the demand from investors). Exchanges that list SMEs already test different solutions to maximize the liquidity in their shares, such as auctions to concentrate trading. In addition to such initiatives, certain policies on trading of shares – for example dark pool trading rules – could also help create greater visible liquidity for smaller shares, since the portion of SME shares traded OTC has significantly increased in the last few year. In the US, the SEC is testing a provision called a trade-at rule that would encourage trading stocks on exchanges rather than rival venues, including dark pools, that have won market share. llvii In the EU, this issue could be picked up in the implementation of MiFID II with the objective of maximizing visible liquidity for the smaller shares. Please note that a recent study commissioned by DG Enterprise lviii also pointed out that "carve-outs for SMEs and those that provide services in that sector" should be considered with respect to rules on, for example, liquidity provision and dark pool trading.
  - ***A single set of accounting rules for finance and taxation****:* Despite efforts to reduce duplication, in practice, European companies still need to produce two sets of accounts: 1) IFRS as the accepted international accounting standard for investor information, which is required to access public markets, but increasingly also by banks with increased documentation and rating requirements; and 2) the national "generally accepted accounting

principles" which serve as the basis of taxation and domestic regulatory reporting. This creates a duplication and, in the case of companies operating in more than one European country, a multiplication of accounting costs and complexity. The lack of harmonisation of taxation and national reporting also complicates financial analysis, since analysts need to familiarise themselves with all the details of national accounting and taxation rules. This is especially a problem for smaller countries since the willingness of investors to research these companies tend to be lower.

Improving financial analysis

- Financial analysts are part of the local ecosystem which has been put under pressure by the various structural changes described above. In addition, given the small size of each single SME investment, obtaining research is usually not viable for institutional investors since the costs are disproportionate to the expected gains. In our view, there is a market failure in the provision of financial analysis on smaller companies, and therefore certain policy actions could be justified to support industry efforts.
- The scarcity of financial analysis has recently been studied[lix] by the European Commission's DG Enterprise, an effort to which we contributed. We find a number of the potential solutions highlighted in the Commission's report promising, and look forward to engaging in the next phase of the project. In particular, the study made **suggestions that would improve the general demand and supply of listed SME research by making SME finance more attractive** – recommending, for example, tax incentives for retail investors for investing in equity and/or by means of pension reforms, simplified reporting and accounting standards for SMEs, removing restrictions on institutional investor, re-balancing investor protection with company disclosure costs, trading methods to concentrate the trading of listed SMEs – all of which we find potentially useful (and some of which are covered elsewhere in this section).
- In addition to these broader suggestions, we also recommend **actions specifically designed to increase the quality and quantity of independent financial analysis on listed SMEs**. This could take the form of a "centralised SME rating and information database" backed by governments and/or **research and company information** being provided by a consortium of industry players in collaboration with the public sector (as suggested in the Oliver Wyman study).[lxi]

Making mid-caps more visible to pan-European investors through an SME Index

- We need to make listed SMEs ***more visible*** as an asset class to local, regional and pan-European investors. Their visibility, in particular vis-à-vis pan-European investors, is quite limited. An investible SME index, for example, could help mid-caps become more visible to institutional investors who are less close to them geographically. ***An SME index*** would enhance the ability of investors to follow SMEs as a unified asset class – and in particular to allow them to invest in the SME index. The conditions for such indices in Europe have to improve. In the US, the indices have a distinction between growth vs value investor. This does not exist in Europe.
- In this context, it is important to note our view that the functioning of a pan-European market for smaller caps does not necessitate the existence of one single pan-European exchange. It has sometimes been argued that a pan-European platform would boost the liquidity of listed SMEs by "uniting the investor pool".[lxi]i However, the lower liquidity of such shares remains a constraint whether or not the investor base is unified through the creation of one listing venue. Moreover, SMEs would face higher barriers to access one central SME market outside of their ecosystem. Moreover, pan-European investors already today follow companies listed on local or regional exchanges as long

as the right mechanism exists to attract their attention.

Increasing the scale of investment in SMEs through funds-of-funds structures – with possible EU public sector help

- One of core problems with listed SMEs is ***the size of the individual investments, which often lack the scale required by institutional investors***. Funds-of-funds solutions could increase the scale of the investment by allowing investors to invest in a larger units while getting exposure to the underlying SMEs.
- While these initiatives can be undertaken by the industry alone, it could also be considered whether EU public sector help – e.g. from the European Investment Fund – could be used as an anchor investor in the creation of such funds so that more private sector funds can be triggered to invest in the critical initial phases. In this context we acknowledge the support given by Mr Juncker for a greater role for the European Investment Bank in financing economic growth. [lxiii]

Boosting investors in listed SMEs through the SME Growth Market

- Another promising action is ***to channel additional investors to invest in listed SMEs*** through the newly created ***"SME Growth Market."*** [lxiv] We support this market, provided that it remains voluntary (i.e., market operators can still operate RMs and MTFs catering to SMEs that are not set up as SME Growth Markets) and it is structured with proper flexibility for the market operator to adapt its market to the targeted investors and companies. It would be particularly useful if the SME Growth Market could be used to channel new investments by making cross-references to this market in other EU legislation affecting ***institutional investors***.
- However, in policies utilising this new market type, two caveats should be kept in mind. First of all, the current threshold (200 million EUR market capitalisation) referred to in the SME Growth Market definition is rather small – in our experience, companies with up 1 billion EUR capitalization can suffer from lower liquidity and therefore merit being helped by policies targeting listed SMEs. Secondly, any investor incentives made available to such markets should also be available to other RMs or MTFs operated by market operators who have chosen not to adopt this model based on objective criteria.

Boosting companies wanting to list

- In terms of keeping issuance costs low for SMEs, the challenge is to find a sensible balance between ***proportionate investor protection and reasonable issuer obligations***. In particular, we must stop using public markets as pioneers of "societal experimentation" – rules for company disclosure should be only for investor protection and market integrity, not for other, societal reasons such as gender equality, environmental protection, etc. Any other information should be provided on a voluntary basis since it can be important to some investors but should not be required as 'listing' criteria for companies. Hence, certain kinds of disclosure which do not serve investor protection or market integrity directly must be kept to a minimum (and ideally be made only voluntary) while all disclosure that serves these purposes should be re-calibrated for proper balance.
- As far as ***financial sector disclosure*** goes, we fully support the review of the rules imposed on companies listed on regulated markets, especially that of the Prospectus Review, as announced in the Commission Communication on long-term financing.[lxv] Along the same lines, there is a need to ensure that the ***accounting rules*** for all companies, but especially listed SMEs, remain manageable. An important element would be to ensure that listed companies are not obliged to do double accounting

– the national sets for fiscal accounting and the IFRS for financial accounting, which creates both a burden to list and a competitive disadvantage vis-à-vis their international peers.

Enabling companies to use a variety of financial instruments

- Finally, companies must be able to use publicly issued or privately placed bonds as a complement to IPOs. For companies seeking to secure ***the most efficient capital mix,*** having access to the full range of instruments and markets – eg private versus public, bond / hybrid vs equity - is vital to ensure a competitive cost of capital. As financial market conditions and company needs frequently change, we must enable companies to keep a maximum of financing options disposable at their hands.

4. Positioning Europe in the world

The EU is a uniquely successful example of regional economic and political integration which underpins its global economic power. Therefore, in the design of policies aimed at improving our capital markets, we should not lose sight of the international dimension of our work, and aim to position Europe in the best way possible.

Mind the Gap

There are two key questions that arise in the international context of the EU Single Market: (1) on what basis should the EU give access to its markets?, and (2) to what extent is the EU's regulatory/supervisory framework an international model for other jurisdictions to emulate?

On the first question, we believe that the EU must remain **open to 3rd countries' investors, issuers, and financial institutions**, while ensuring adequate protection for European investors, proper supervision by European supervisors, and fair competition based on a level playing field among all institutions. The European capital markets are governed by the principle of trust in the mutually shared principles of other jurisdictions. We believe that Europe must make further progress in this area: the framework for access by 3rd country participants is currently not complete. Some aspects have been covered by MiFID II, but there are also gaps (eg regarding the conditions of access for market operators).

On the second question, it is a fact that several jurisdictions – eg from Africa or Asia – have looked at the EU model as an inspiring model of regional integration for their capital markets. While avoiding extraterritoriality, Europeans should continue to promote the European regulatory model as best practice around the world whenever appropriate. Hence, Europe needs to assert its principles and values more independently of other jurisdictions (while actively shaping international standards).

Policy Recommendations: Positioning Europe in the world

Ensuring that European capital markets remain open to the world and at the forefront of international standards

- In the coming legislative period, efforts should focus on clarifying the basis on which access to the European market is to be provided. We need to remain open to the outside world, but ensure that this access satisfies the major policy objectives we have for our citizens and economies. The current TTIP negotiations – if they result in the inclusion of financial services - should be seen in this context.
- Specifically, the terms on which access is provided need to ensure adequate protection for European investors, proper supervision by European supervisors, fair competition and level playing field among all institutions, as well as building on the principle of trust in the mutually shared principles of other jurisdictions.

Promoting the EU regulatory model

- In terms of promoting the EU "regulatory model," we believe Europe needs to be more active especially in the developing world. There are various regional integration projects for which the EU model could be relevant, as well as single jurisdictional reforms to which the EU model contribute.

5. Improving safety

The prerequisite to meeting investor needs and growing the size of markets is to **regain investor confidence.** While we implement the above recommendations in Sections 1-4, we should not lose sight of the real and perceived degree of safety of European capital markets.

According to the Chicago Booth/Kellogg School Financial Trust Index, only 15% of the public trusted stock markets as of December 2013, compared to 35% trust expressed for banks, 31% for mutual funds and 17% for large corporations. (The trust towards stock markets and banks showed a downward trend over 2013). While an equivalent poll does not exist for Europe, it is reasonable to expect that the last crisis has led to a loss of confidence in European capital markets as well – which came on top of the severe impact on confidence of the last crisis in 2000. While it is clear that the financial crisis of 2008 originated in the less regulated parts of the market which had little to do with the public capital markets, and that the stock exchanges in particular remained healthy, robust and transparent all throughout the crisis, all parts of the market have been affected by the loss of confidence. To regain this lost trust, capital markets must not only be fair and safe, but they must be perceived to be so.

Importantly, by "safety" we do not mean that markets never lead to losses for any investors: Clearly, this would go against the basic principles of functioning of any market and take away the element of risk, which is fundamental to efficient markets. Rather, we mean that systemic risk should be reduced to the minimum and investors be reassured that capital markets are open, well-regulated, transparent, fair, and not reliant on state or taxpayer money.

Mind the gap

Below, we describe the major areas in which markets must become safer.

Transparency and neutrality of some of the market segments:

MIFID I only had a minimal set of rules applying to non-equities markets. In contrast to such instruments traded in OTC markets, equity, bonds and derivatives traded on **Regulated Markets** played a crucial role in maintaining the long-term safety of Europe's capital markets – and have shown to reduce systemic risk during the crisis.

These issues, together with the G20 commitments arising from the financial crisis, formed the background to the review of MIFID I launched by the Commission in October 2011 and finalised in 2014. We support the outcome and reiterate that the new regime must be implemented fully and consistently.

With the MiFID II regime currently being implemented, secondary market trading in all venues, including bank-operated ones, should become more transparent and less segregated. Correct implementation is especially important given that MiFID I was not implemented in the way it was originally designed, and as a result led to a number of important problems in terms of the transparency of markets.

Despite the decline of explicit trading costs – driven by MIFID I in Europe - and great efficiency gains in technology, European secondary markets have not reached their potential in terms of creating a truly integrated liquidity pool. As we describe in Section 3, this is because MIFID I weakened the ecosystem in many markets, notably those for SMEs and midcaps. In addition, the MIFID I saw an increase of private markets and opaque trading in some market segments. Equity markets, traditionally the most regulated and transparent of all markets, saw increased market fragmentation (as the natural by-product of competition) accompanying the growth of unregulated dark pools and the continuing opacity of OTC data.

In addition, fragmentation of the secondary markets was accompanied by a "privatisation" of order flow. These three elements – fragmentation, opaque trading and 'privatisation' of order flow - have given rise to the following risks: (i) deteriorating market quality (less efficient price discovery process, less efficient allocation of capital as a result), (ii) deteriorating execution quality (dark venues often use lit venue's prices to determine their own prices, yet at the same time empty these venue's order books which therefore provide unrepresentative prices), (iii) cream-skimming, and (iv) conflicts of interest between best execution requirements for

intermediaries and their financial interests in execution venues they co-own.

Overall, fragmentation / privatisation of flows and opaque trading are contradictory to the capital markets' fundamental role in the economy. In addition, there are significant risks of conflicts of interests that emerge when a private pool of investors determines prices which will in turn determine the valuation of a company and hence its ability to raise money, often from those same investors. The risks raised by increased dark trading and the unfair treatment of investors accessing dark pools in comparison to those that reveal their trading interests on pre-trade transparent venues that are being free-ridden have recently been well documented.

Clearing of the remaining bilateral OTC derivatives:

With regard to the **clearing of the remaining bilateral OTC derivatives**, it needs to be clarified what will happen in the case of a failure or bankruptcy. In addition, the transparency of non-equity instruments needs to improve (as planned under MiFID II) to improve the safety of the system.

Recovery of costs of an appropriate return on such activities as trading / data distribution / clearing

The implementation of the various measures related to G20 and MiFID II should ensure that the operators of such activities as trading, data distribution and clearing are able to properly charge for the costs of running their platforms. Hence, we should avoid the risk of "price dumping" on venues.

New ways of accessing markets :

Another source of risk to the system could come from the new ways of accessing markets – such as crowd-funding – where we need to avoid fraud that would further erode public confidence.

Ensuring cross-border surveillance of the multi-venue trading structure:

While individually trading venues execute robust surveillance, and while certain types of surveillance are carried out by supervisors, an overall pan-European view of cross-border trading does not yet exist due to insufficient standardisation.

FESE's Policy Recommendations: Improving safety

Transparency and neutrality of some of the market segments

- With respect to **equity markets**, many of the reforms agreed in MIFID II / MIFIR have the potential of correcting the deficiencies outlined above. Examples are the requirement to trade shares on MIFID regulated venues as well as moves to restrict forms of dark trading which do not provide any real benefit to the price formation process.
- However, the most significant source of risk to the system is the structure of trading in some market segments which remains bilateral, transparent and segregated. Hence, regulators and policymakers should retain a focus on measures to increase the **neutrality, transparency and integration of trading flows in all asset classes.** The buy-side needs to be able to invest through secondary markets that are fair and transparent (e.g. dark pools must treat all investors equally). This will help build investors' confidence in markets' ability to deliver on their needs and to treat them fairly.
- Moreover, we need open and fair markets where **all investors are treated equally** to reinstate investor trust. For example, we need to address the **conflicts of interests** inherent in the processing of order flow to ensure that the flow is processed into transparent venues and not diverted to participants' own trading books. In this regard, markets should be built on the principle of no segregation among investors.
- For **non-equities**, Europe needs to implement via the agreed MiFID II / MiFIR framework the **agreed G20 reforms** to improve the safety and integrity of all derivatives trading and clearing, while maintaining their positive contribution to the economy and the financial sector.

- Policymakers and regulators should also revisit the transparency and trading framework applied to bonds as the reforms have not gone as far in respect of this asset class as with derivatives.

Clearing of the remaining bilateral OTC derivatives

- The **clearing of the remaining OTC derivatives** must be managed in a way that reduces systemic risk. In this regard and with regard to the transformation of private trading markets, the implementation of the G20 measures will be critical to the safety of Europe's capital markets.

Fairness in competition among platforms

- The implementation of the various measures related to G20 and MiFID II should not lead to unfair competition. We should ensure that trading venues are able to properly charge for the **costs of running their platforms**. Hence, we should avoid the risk of "price dumping" or other distortive practices on venues.

Regulating new ways of accessing markets appropriately

- New ways of accessing markets – such as crowd-funding- should be **properly regulated to prevent the risk of fraud and scandals**, which could further erode public confidence. This must be balanced against the need to encourage new ways of investing. We note the current decision of the European Commission not to take a legislative action with regard to the gaps in the regulation of crowdfunding identified in the 2013 consultation, and agree with the reasons cited for the wait-and-see approach for the moment.
- At the same time, we believe that the rules applicable to crowdfunding in various Member States should be monitored carefully for signs of any significant divergence, since they could harm the Single Market.
- Moreover, in the near future, the European Commission should re-visit the option of closing the regulatory gaps regarding crowdfunding in a way that ensures the proper functioning and growth of these platforms in safety to provide a new means of source of financing for companies.

Ensuring cross-border surveillance of the multi-venue trading structure

- In the long run, Europe needs to have a more holistic system of cross-border surveillance to match its fragmented trading structure. While we wait for the review required by the recently made changes to the Market Abuse regime, we believe that the further standardisation of data accessible to supervisors will enhance their abilities to supervise the trading across venues.
- In addition, projects such as clock synchronization should be considered to improve cross-border safety and surveillance through a combination of regulator and industry efforts.

End notes

[i] European Commission Communication on Long-term financing of the European economy, 27 March 2014. http://ec.europa.eu/internal_market/finances/docs/financing-growth/long-term/140327-communication_en.pdf, page 2.

[ii] http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=lfsi_emp_a&lang=en

[iii] http://ec.europa.eu/about/juncker-commission/docs/pg_en.pdf

[iv] http://files.gereports.com/wp-content/uploads/2012/06/TheMightyMiddle-GECapital.pdf
http://www.essec.edu/faculty/showRef.do?bibID=10477

[v] See Chart A: IPOs Finance Significant Job Creation, cited in Rebuilding the IPO On-Ramp Putting Emerging Companies and the Job Market Back on the Road to Growth, http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf Original data quoted comes from the Venture Impact 2007, 2008, 2009, & 2010 by IHS Global Insight; IPO Task Force August 2011 CEO Survey.

[vi] http://www.mckinsey.com/insights/global_capital_markets/mapping_global_capital_markets_2011

[vii] European capital markets are much smaller than those of the US and are not growing at a sufficient speed to meet the economy's needs. According to a Bruegel Working paper, bank credit to the private sector as a percentage of GDP is 104% in the EU while it is 43% in the US. Conversely, stock market capitalization is 75% of EU GDP according to FESE statistics, whereas in the Working Paper it is 136% of US GDP. This is a fact recognised by the European Commission's Communication on Long-term financing of the European economy. While it is not reasonable to expect the share of European market-financing to resemble that of the US in a few years, it is clear that European capital markets need to grow further (in a sustainable and safe way) so that they can meet more of the needs of the economy. This is necessary above all because banks will face increasing difficulties to fund our economies. See "The Changing Landscape Of Financial Markets In Europe, The United States And Japan", Michiel J. Bijlsma and Gijsbert T. J. Zwart, March 2013.

[viii] http://www.world-exchanges.org/files/statistics/pdf/2014_1H_WFE_Market_Highlights.pdf Please note that the use of GDP as a denominator should be read in the context of different government spending across jurisdictions. Since government spending is a bigger share of GDP in Europe than in the US, this measure should be read together with other statistics. However, the distribution of enterprise funding sources in the US and the EU between banks and markets is also fully consistent with the GDP-based statistics.

[ix] Paper commissioned by OECD, "Making Stock Markets Work to Support Economic Growth / Implications for Governments, Regulators, Stock Exchanges, Corporate Issuers and their Investors", David Weild, Edward Kim and Lisa Newport: http://www.oecd-ilibrary.org/governance/making-stock-markets-work-to-support-economic-growth_5k43m4p6ccs3-en

[x] 26 of the 28 EU member countries are represented by FESE. The ones which are not represented are Italy and Croatia. In addition, some non-EU member states are also represented by FESE: Armenia, Iceland, Norway, Switzerland, and Turkey (as full members) and Israel and Russia (as observer members).

[xi] For a reference on the positive role of stock exchanges in respect to economic growth (level and rates) please see Levine, R. 1991. "Stock Markets, Growth, and Tax Policy." Journal of Finance, Vol. XLVI: 1445-1465 and (ii) Levine, R., and S. Zervos. 1998. "Stock Markets, Banks, and Economic Growth" American Economic Review, Vol. 88:537-58.

[xii] http://www.fese.eu/en/?inc=news&id=232

[xiii] European capital markets are much smaller than those of the US and are not growing at a sufficient speed to meet the economy's needs. According to a Bruegel Working paper, bank credit to the private sector as a percentage of GDP is 104% in the EU while it is 43% in the US. Conversely, stock market capitalization is 75% of EU GDP according to FESE statistics, whereas it is 136% of US GDP. This is a fact recognised by the European Commission's Communication on Long-term financing of the European economy. While it is not reasonable to expect the share of European market-financing to resemble that of the US in a few years, it is clear that European capital markets need to grow further (in a sustainable and safe way) so that they can meet more of the needs of the economy. This is necessary above all because banks will face increasing difficulties to fund our economies. See "The Changing Landscape Of Financial Markets In Europe, The United States And Japan", Michiel J. Bijlsma and Gijsbert T. J. Zwart, March 2013.

[xiv] http://www.eesc.europa.eu/resources/docs/guillaume-prache---eurofinuse.pdf

[xv] Please see: http://www.efama.org/about/SitePages/Home.aspx and Mirzha de Manuel, Saving for Retirement and Investing for Growth: Report of the CEPS-ECMI Task Force on long-term investing and retirement savings, Centre for European policy studies & European capital markets institute, Brussels. EFAMA is the representative association for the European investment management industry. EFAMA represents through its 27 member associations, 62 corporate members and 25 associate members about EUR 15 trillion in assets under management of which EUR 9.8 trillion managed by 55,000 investment funds at end December 2013. When referring to households' financial assets, it is also important to note the amount of cash held by households and currently unallocated, which includes equity and fixed income. Cash and equivalent held are $12 trillion in 2010. This is quite a high number of available liquidity that could move into other financial products via direct access (retail investors).

[xvi] According to the McKinsey Global Institute, supply of equity issued in Western Europe between 2010-2020 is expected to exceed the demand from investors by 3.1 trillion USD (2 trillion EUR). In other words, there will be 2 trillion EUR more equity that needs to be issued than investors are willing to buy. This "equity gap" for the whole EU is estimated to be larger. The gap is the result of a number of long-term structural factors, such as deleveraging, aging population, etc. This shows that European equity markets need to grow significantly if they are to meet the needs of

European enterprises over the next decade. The Emerging Gap: Growth and stability in the new investor landscape, Charles Roxburgh, Susan Lund, Richard Dobbs, James Manyika, Haihao Wu, December 2011 (page 7 – Exhibit E5)

[xvii] file:///C:/Users/richard/Downloads/The%20changing%20landscape%20of%20financial%20markets%20in%20Europe,%20the%20United%20States%20and%20Japan%20(English).pdf

[xviii] file:///C:/Users/richard/Downloads/Liquidity%20provision%20in%20bond%20markets%20by%20the%20buy-side%20June%202013.pdf

[xix] Page 15 of the Communication on Long-term financing of the European economy.

[xx] See for example "Restoring financing and growth to Europe's SMEs" by Bain & Company and the Institute of International Finance http://www.bain.com/publications/articles/restoring-financing-and-growth-to-europes-smes.aspx

[xxi] Against this background, important distinctions between market segments that meet diverse investor needs are non-OTC vs OTC, and CCP vs non-CCP, which will also be discussed in the context of safety under section 5.

[xxii] What is active investment is a subject for debate. We could define active/passive as 1) the selection of the individual securities vs the portfolio, or 2) the exercise of shareholder/creditor rights. By either measure, the market has become more dominated by passive investment.

[xxiii] See Part III, p. 27, in Who Cares? by Isaksson and Çelik. Among others, the authors note, "In most OECD countries the majority of traded shares are held by intermediaries, such as pension funds, mutual funds and insurance companies, that basically invest the money of ultimate savers for a fee. While intermediation in itself lengthens and weakens the link between savers and corporations, the presence of proxy advisors, asset managers and other service providers in the investment chain also make the corporate governance process more complex. With every additional actor, there is a risk that the ultimate saver's objectives becomes misaligned. This misalignment may not only be in terms of investment strategy but in terms of corporate governance priorities as well."

[xxiv] http://www.bis.gov.uk/assets/biscore/business-law/docs/k/12-917-kay-review-of-equity-markets-final-report.pdf

[xxv] This is also noted in the OECD report by Isaksson and Çelik.

[xxvi] http://www.eurofinuse.org/fileadmin/user_upload/documents/Position_Papers/Securities_Market/EuroFinUse_Position_on_the_proposals_in_MiFID_II_on_capital_market_structures.pdf

[xxvii] See page 10 of the OECD report, "Annual Survey of Large pension Funds and Public Pension Reserves," http://www.oecd.org/daf/fin/private-pensions/LargestPensionFunds2012Survey.pdf

[xxviii] page 14 of the McKinsey study:http://www.mckinsey.com/insights/global_capital_markets/emerging_equity_gap

[xxix] See the analysis of the Citibank report "Equity Cult is Dead" in http://www.zerohedge.com/article/why-end-equity-cult-means-trillions-upcoming-outflows-stocks

[xxx] Weild et al, Exhibit 9.

[xxxi] Chart A : IPOs Finance Significant Job Creation, cited in Rebuilding the IPO On-Ramp Putting Emerging Companies and the Job Market Back on the Road to Growth, http://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf Original data comes from the Venture Impact 2007, 2008, 2009, & 2010 by IHS Global Insight; IPO Task Force August 2011 CEO Survey.

[xxxii] According to the Communication on Long-term financing of the European economy, SMEs account for two thirds of employment and 60% of value added in Europe. (Page 2). A Swedish study states that in the last 10 years, around 80% of all new jobs in Sweden have been created in companies with fewer than 50 employees. Similar figures are reported in other EU countries.

[xxxiii] http://files.gereports.com/wp-content/uploads/2012/06/TheMightyMiddle-GECapital.pdf

[xxxiv] From the study: « If this relatively small group of mid-market firms was able to grow headcount at just 2% a year (representing 650,000 jobs) between now and 2015, that alone would be enough to push EU-4 [these 4 countries] unemployment levels back to those last seen in 2007. »

[xxxv] http://www.essec.edu/faculty/showRef.do?bibID=10477

[xxxvi] See p8 in Oliver Wyman, "Towards Better Capital Markets Solutions for SME Financing," Daniela Peterhoff, John Romeo, and Paul Calvey:
http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/2014/jul/FINAL_BetterCapitalMarketMechanismsSMEs.pdf

[xxxvii] See the OECD paper "Who Cares? Corporate Governance in Today's Equity Markets" http://www.oecd-ilibrary.org/governance/who-cares-corporate-governance-in-today-s-equity-markets_5k47zw5kdnmp-en by Mats Isaksson and Serdar Çelik and paper commissioned by OECD, "Making Stock Markets Work to Support Economic Growth / Implications for Governments, Regulators, Stock Exchanges, Corporate Issuers and their Investors", David Weild, Edward Kim and Lisa Newport http://www.oecd-ilibrary.org/governance/making-stock-markets-work-to-support-economic-growth_5k43m4p6ccs3-en

[xxxviii] Weild et al

[xxxix] Please see Exhibit 7 in Weild et al, which shows global and U.S. IPO trends from 1993 to 2012, as compiled by the OECD. The authors believe the OECD data to be « the most accurate numbers available », offering the following observations: « The global number of IPOs declined from over 2 000 per year in the early 1990s to less than 750 in 2012. And the IPO decline is widespread and not confined to U.S. markets and therefore, likely precipitated by the proliferation of computer-based trading and low- transaction-cost electronic markets. »

[xl] Public company listings peaked in the U.S. in 1997, with 8,823 exchange-listed companies. At the end of 2012, there were only 4,916 — a massive decline of 44.3%. Since the peak, the U.S. has suffered 15 consecutive years of lost listings. As the world's largest economy, the U.S. should be producing five to 10 times the number of IPOs it has produced over the past 13 years.

[xli] Poland, UK, France, Italy, Spain, Germany. Two additional non-EU European countries (Norway and Turkey) were

also in the top 26.

[xlii] For further analysis on the world-wide IPO decline and possible reasons, please also see the OECD report "Who Cares? Corporate Governance in Today's Equity Markets" http://www.oecd-ilibrary.org/governance/who-cares-corporate-governance-in-today-s-equity-markets_5k47zw5kdnmp-en by Mats Isaksson and Serdar Çelik.

[xliii] Oliver Wyman, Towards Better Capital Markets Solutions for SME Financing", Daniela Peterhoff, John Romeo, Paul Calvey, 2014.

[xliv] "In the early 1990s, we witnessed over 520 IPOs per year in the U.S., 80% of which were small deals raising less than USD 50 million. Just twenty years later, that average has dwindled to fewer than 130 transactions, with just 113 in 2012, of which only 14 were small deals". Page 15, Weild et al.

[xlv] Latest breakdown available by this segment in FESE statistics (2009).

[xlvi] http://ec.europa.eu/enterprise/policies/sme/files/sme_definition/sme_user_guide_en.pdf

[xlvii] FESE members operate 23 Regulated Markets that list more than 9,000 companies, out of which 7,900 are small and mid-cap (below 750 million EUR market capitalisation). In addition, FESE member exchanges have also established 13 MTFs dedicated to SMEs, which list a total of another 1,470 SMEs. In total, about 9,370 companies on FESE members are Midcaps/SMEs (with another 2,000 plus SMEs listed on the LSE and Borsa Italiana, bringing the total figure to 11,370). Hence, we could say that Europe has more than 11,000 listed SMEs.

[xlviii] Securities and Markets Stakeholder Group – Report on Helping Small and Medium Sized Companies Access Funding: An own-initiative report by the Securities Markets Stakeholder Group to the ESMA Board of Supervisors.

[xlix] On Feb. 11, 2014, the "Small Cap Liquidity Reform Act of 2013" passed the U.S. House of Representatives by a vote of 412 to 4. It will enable public companies with market values under 750 USD million to choose a tick size of 5 cents or 10 cents per share instead of the current one-size-fits-all tick size of only 1 cent per share. See http://tabbforum.com/opinions/uncommon-cents-making-stock-markets-work-to-support-economic-growth?print_preview=true&single=true for an analysis of this policy change.

[l] In particular Sarbanes-Oxley.

[li] The Global Settlement was an enforcement agreement reached on April 28, 2003 between the SEC, NASD, NYSE, and ten of the United States' largest investment firms to address issues of conflict of interest within their businesses. For more, see http://www.sec.gov/news/speech/factsheet.htm

[lii] See pages 18-23 in Weild et al as well as "Market structure is causing the IPO crisis – and more" by David Weild and Edward Kim, Grant Thornton Capital Market Series, June 2010, pp 21-24.

[liii] Latest breakdown available by this segment in FESE statistics (2009).

[liv] Page 8, footnote 28 concerning the Task Force established by the Federation of European Securities Exchanges (FESE), EuropeanIssuers and the European Private Equity and Venture Capital Association (EVCA). See http://www.fese.eu/en/?inc=cat&id=8

[lv] Oliver Wyman, Towards Better Capital Markets Solutions for SME Financing", Daniela Peterhoff, John Romeo, Paul Calvey, 2014.

[lvi] Exhibit 12, David Weild et al.

[lvii] JOBS Act Rewards U.S. Stock Exchanges With IPOs Amid Criticism (18.08.2014 / tradersmagazine.com, USA / By Doni Bloomfield)

[lviii] ECSIP Consortium, Improving the market performance of business information services regarding listed SMEs, Final Report, Rotterdam, September 2013

[lix] ECSIP Consortium, Improving the market performance of business information services regarding listed SMEs, Final Report, Rotterdam, September 2013

[lx] Please see the final report of the study on «Improving the market performance of business information services regarding listed SMEs,» available on http://ec.europa.eu/enterprise/newsroom/cf/itemdetail.cfm?item_id=7562&lang=en&title=Improving-the-market-performance-of-business-information-services-regarding-listed-SMEs

[lxi] Oliver Wyman, Towards Better Capital Markets Solutions for SME Financing", Daniela Peterhoff, John Romeo, Paul Calvey, 2014.

[lxii] "Finance For Growth Report Of The High Level Expert Group On SME And Infrastructure Financing" issued on 11 December 2013, http://europa.eu/efc/working_groups/hleg_report_2013.pdf

[lxiii] See page 3 of his speech: http://ec.europa.eu/about/juncker-commission/docs/pg_en.pdf

[lxiv] See page 8 of the Communication on Long-term financing of the European economy.

[lxv] See page 9 of the Communication on Long-term financing of the European economy.

[lxvi] http://www.financialtrustindex.org/resultswave21.htm

[lxvii] See Walras' principles. The negative impact of internalisation and of broader order preferencing practices has been demonstrated in M. O'Hara & J. R. Macey, Law and Economics of Best Execution, Journal of Financial Intermediation, Vol. 6, No. 3 (1997).

[lxviii] Please see P. Gomber and A. Pierron, MiFID, Spirit and Reality of a European Financial Markets Directive, September 2010.

[lxix] http://ec.europa.eu/internal_market/finances/crowdfunding/index_en.htm

[lxx] http://ec.europa.eu/internal_market/consultations/2013/crowdfunding/index_en.htm