European IPO Report 2020

Recommendations to improve conditions for European IPO markets

Contents

Disclaimer

The European IPO Report 2020 is intended for general information only.

Foreword

As Chair of the European IPO Task Force, I would like to thank the co-organisers Accountancy Europe, CFA Institute, European Bank for Reconstruction and Development (EBRD) and Federation of European Securities Exchanges (FESE) as well as the participants of the Task Force who contributed towards a well-structured report which provides important recommendations.

The new European Commission has taken office and has set out an ambitious work programme. When it comes to supporting the economy, policy measures to address the declining numbers of initial public offerings (IPOs) on European markets should be a top priority.

This report outlines the issues at stake and presents policy recommendations to reverse the trend and addresses policy-makers, regulators and market participants at the European and national level. In particular it offers input to the European Commission's strategy on small and medium-sized enterprise capital market financing, particularly the private-public fund initiative to support IPOs.

The number of IPOs on European markets has been falling for more than 20 years, with consequences for society. Markets that have a higher share of equity financing are better equipped to handle economic shocks, create jobs, allow investors to participate in the value creation of fast-growing companies, and allocate more funding towards a sustainable economy. The European economy should thus be less reliant on bank-based financing. Moreover, the current environment where fewer companies decide to list on public markets leads to less transparency as private companies are not subject to the same reporting requirements.

This report provides an overview of issues that companies, investors, exchanges and other market participants are facing in trying to promote companies' access to capital market financing and suggests measures to address these challenges.

We look forward to engaging further on these topics and stand ready to provide advice on how to improve conditions on European IPO markets.

Caroline Nagtegaal, Member of the European Parliament (VVD/ Renew Europe) and Chair of the European IPO Task Force

Executive Summary

An Initial Public Offering (IPO) is the process whereby a company offers its shares to the public in conjunction with a listing of its shares for trading on an official stock exchange. Following the IPO, investors can then buy and sell shares in the company on the exchange.

In this report, the European IPO Task Force makes a series of recommendations to improve conditions for European IPO markets. These recommendations should serve as inspiration for the European Commission in developing its new SME strategy and Capital Markets Union (CMU) initiatives.

The European IPO Task Force was first established in 2014 to raise awareness of key obstacles to efficient IPO markets and provide recommendations on areas requiring action. The work carried out resulted in a report published in 2015, available on the FESE website.

Six months later, the European Commission launched the Capital Markets Union Action Plan with the objective to strengthen long term investments by creating stronger capital markets that would "provide new sources of funding for business, help increase options for savers and make the economy more resilient". The Action Plan contained several measures to increase the accessibility of the public capital markets for European companies. However, since then, the number of listed companies has decreased by 600 and 50 fewer IPOs took place in 2018 compared to 2015.[1] A clear indication that European IPO markets are still facing several obstacles and that concerted efforts from both policymakers and industry are needed to reverse the negative trend on European IPO markets.

The European IPO Task Force was relaunched in 2019 to assess recent IPO market developments and re-assess the recommendations provided by the Task Force in 2015. The European IPO Task Force is composed of corporate representatives and independent experts from major segments of the financial sector involved in the admission of companies to listing (for a full list of participants and observers please see chapter 7).

During 2019, the Task Force met on three occasions and the debates held resulted in the present report which proposes several recommendations to improve European IPO markets.

We first focus on how we can improve the IPO ecosystem, including how to ensure that there is a level playing field between requirements applicable to public and private companies; requirements for smaller companies are proportional; research is available and that measures, such as the European private-public fund, are targeted to support listing, both on main markets and smaller markets.

The report continues with a series of recommendations on how to promote investors' participation in IPO markets, including: ensuring that pension saving through equity investments by both retail and institutional investors is encouraged, promoting dialogue between companies and their shareholders and guaranteeing that company information is easily accessible.

We then consider how we can improve the European equity culture through financial education of investors, companies and advisers.

These recommendations should serve as inspiration for the European Commission in developing its new SME strategy and Capital Markets Union (CMU) initiatives.

Another important consideration is that of tax incentives and the need to remove the tax bias in favour of debt to encourage equity investments. The Task Force proposes measures that should be addressed to Member States with a role for the European Commission in spreading awareness. The chapter concludes by emphasing the need to not adopt measures that discourage equity investments.

Technological developments are integral to financial markets and we examine how this can be supportive to the opportunities and challenges in IPO markets. The Task Force recommends harnessing technologies to e.g. improve information sharing, connectivity and participation, while at the same time ensuring that the principle of "same business, same rules" is followed.

The final chapter describes the vital role equity markets have supporting the transition towards a sustainable economy.

Recent market developments show the rapidly rising interest in sustainable investments. Empirical evidence shows how equity markets facilitate the transition as resources are reallocated to more carbon effective uses, demonstrating that promoting CMU and sustainable finance are mutually reinforcing projects.

It should be noted that, while the outcomes of the Brexit process will no doubt affect European IPO markets, there is currently little clarity so this report will not consider potential effects.

Well-functioning IPO markets support company financing, promote employment, provide citizens with efficient investment opportunities for their pension needs and ensure resources are allocated to their most productive use, including towards the transition to a sustainable economy.

The European IPO Task Force therefore saw a need to again come together to call on policymakers and stakeholders to take measures to revive European IPO markets. This report provides an overview of the issues at hand and presents recommendations on how to address them.

Summary of recommendations

1. Improving IPO ecosystems for companies and investors by creating a more flexible regulatory environment for listed small and mid-cap companies

Recommendations	Key stakeholders
Adopt proportional requirements for smaller companies	
Establish a level playing field in requirements applicable to private and public companies, as well as an appropriate level of investor protection which includes a European collective redress mechanism.	European Commission
Discuss EU financial regulation following a 'do small first'-mindset to avoid a 'one-size-fits-all'-framework e.g. MAR and Prospectus requirements should be simplified to decrease the administrative costs of doing an IPO, while ensuring relevant information is disclosed in a reliable and proportionate manner.	European Commission
Continuously undertake specific impact assessments looking at the effect of legislative proposals on smaller public companies throughout the legislative process.	European Commission, European Parliament, Council
Promote SME Growth Markets	
Raise the threshold for companies for qualifying for SME Growth Markets status to EUR 1 billion market capitalisation.	European Commission
Allow special segments of regulated markets to benefit from SME Growth Market status and simplifying access to both SME Growth Markets and regulated markets.	European Commission
Promote the provision of equity research on SMEs	
Adress any unintended effects which MiFID II might have had on the quality and amount of equity research for SMEs.	European Commission
Improve access to equity research on SMEs by:	
• Launching a Pan-European program to cover the costs of research coverage.	European Commission
• Establishing user-friendly platforms for analysts to share their reports on.	Industry
• Amending unbundling rules to allow brokers to send SME-research reports to fund managers.	European Commission
Adapt regulation and policy measures to promote listing	
Further the European Commission's proposal for a private public fund for IPOs which provides capital to companies and could support equity research, provide repayable loans and stimulate secondary market liquidity.	European Commission
Further simplify disclosure requirements for secondary public offers in the Prospectus Regulation.	European Commission
Allow market operators themselves to determine tick sizes for SME shares.	European Commission
Review the settlement arrangements for illiquid stocks under CSDR.	European Commission
Provide targeted support to smaller markets	
Provide targeted assistance and proportional requirements for smaller markets to reach their full potential.	European Commission Member States
Take measures to develop smaller markets: • Run an assessment of the impact of legislative files • Provide technical assistance to support implementation of EU laws at national level. • Propose longer time periods for transition and implementation.	European Commission
When applicable, for index purposes, consider a regional approach rather than classifying countries separately.	Industry

2. Promoting investors’ participation in IPO markets

Recommendations	Key stakeholders
Channel retail savings into capital markets and equity investments and support retail investors in making provisions for their retirement savings.	European Commission, Member States Industry
Reconsider requirements and supervisory practices that prevent pension funds from investing in equity or companies listed on SME Growth Markets	European Commission, Supervisory Authorities
Introduce a definition for ‘experienced and knowledgeable High Net Worth investors’ for these to have tailor-made investor protection rules.	European Commission
Lower equity capital charges under Solvency II to remove one important bias against equity investment and ensure institutional investors can invest in equity.	European Commission
Encourage better dialogue between European companies and their investors during the IPO process and listing. Using digital means to this effect should be encouraged.	Industry
Amend regulation to support companies in organising and conducting hybrid annual general meetings of shareholders.	European Commission, industry
Monitor the implementation of SRD II to ensure that the intentions of the co-legislator are respected.	European Commission
Remove barriers between issuers and the legal owners of shares. Include an overall exemption in rules and regulation regarding ‘acting in concert’ if legal owners of shares are engaging with European companies during the IPO process and listing.	European Commission
Accelerate the European Electronic Access Point project under the Transparency Directive to promote access to company reporting across the EU.	European Commission

3. Creating a European equity culture

Recommendations	Key stakeholders
Launch public campaigns to support companies’ financial education about capital market financing and investment.	Industry, Member States, European Commission, ESMA
Promote financial literacy of investors through educational programmes included in national curricula.	Member States
Promote education of financial advisers.	Industry

4. Improving tax incentives for investment in IPOs and equity overall

Recommendations	Key stakeholders
End tax discrimination of equity compared to debt and adopt measures to instead favour equity investments.	Member States
Review fiscal incentives and reduce or eliminate tax costs that may occur at the IPO stage for employees, management and owners.	Member States
Provide tax incentives to encourage investment in SME growth companies and simplify the frameworks for employee share options.	Member States
Share best practices among Member States to promote equity investments.	European Commission
Create a robust EU framework for withholding taxes.	European Commission
Conduct a study on tax incentives for SMEs, specifically when they are seeking debt or equity financing.	European Commission
Set up a pan-European credit referral and mediation scheme for when an SME's bank loan request has been rejected.	European Commission
Assess state aid measures, as this may help to achieve more cross-border savings if incentives were harmonised.	European Commission
Avoid adopting tax policies which would discourage investors from investing in capital markets, such as the Financial Transaction Tax	European Commission, Member States

5. Building a regulatory framework that favours technological innovation and can handle potential regulatory adjustments

Recommendations	Key stakeholders
Safeguard the level playing field between capital raising activities through new technologies by applying the principle "same business, same rules"	European Commission
Clarify the application of existing financial regulation to virtual assets.	European Commission

6. Capital markets' vital importance in supporting the transition to a sustainable economy

Recommendations	Key stakeholders
Develop a long-term sustainable finance vision which is proportional to company size and ensures a level playing field between public and private markets.	European Commission
Incentivise market agents towards longer-term orientation by: • Ensuring non-financial reporting requirements are proportionate especially for small growth companies. • Reassessing the range of factors needed to incentivise market participants in evaluating longer-term risks. • Consistent, comparable and material reporting on non-financial information by issuers.	European Commission
Ensure alignment of different pieces of legislation, e.g. reporting requirements with the taxonomy provisions and other regulations.	European Commission

Introduction

The importance of well-functioning equity markets

For society, the benefits of well-functioning capital markets include enhanced economic growth, greater wealth distribution, innovation and an economy more robust to shocks. There is a strong correlation between capital market development and economic performance and growth. Considering public markets only, the relationship is estimated to be 1-to-1, i.e. a public market growing by one-third is estimated to raise real economic growth by one-third.[2]

The European economy relies strongly on bank based financing but the last financial crisis proves that the need to strengthen the equity capital of the corporate sector in Europe is essential in order to build up a resilient private sector that can adapt fast and flexibly to economic turbulence and the new challenges that climate change and digital transformation will bring. Equity capital has by nature a larger risk appetite than any other means of funding; such risk appetite is a prerequisite to building a more innovative economy in Europe.

Public markets open the door to the largest pool of equity capital and accessing this provides almost unlimited opportunities for companies to fully exploit their growth potential. In addition, the public markets have other important benefits for companies to:

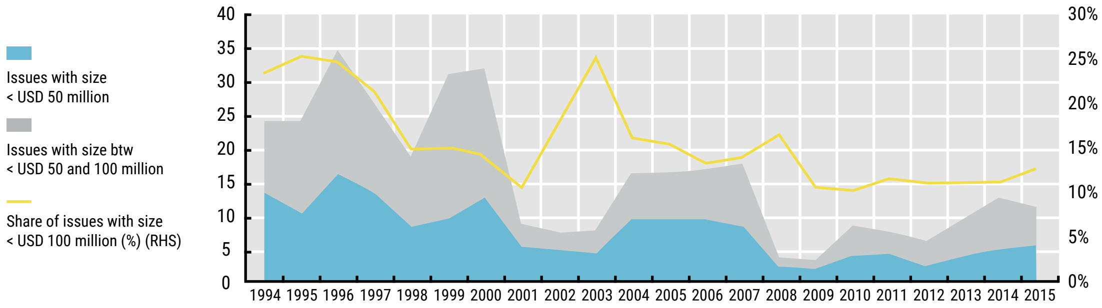
- *Finance sustainable, long-term growth while preserving the independence of the company and allowing the original owners to decide whether and when to retain or pass on control;*
- *Diversify the investor base;*
- *Lower overall funding costs, as listed entities usually also have lower costs of debt;*
- *Motivate staff, promote loyalty and increase the companies' ability to attract young talents (e.g. through employee share schemes);*
- *Enhance the company's profile and reputation because listing on a regulated exchange or SME (Small and Medium Enterprise) Growth market is effectively a quality mark that demonstrates that a company has achieved a recognised level of governance and transparency.*

Public markets have a critical role in creating wealth for the society. A stronger reliance on public equity funding allows the widest circle of private individuals, i.e. citizens of the European Union, to participate and profit from the growth of the European corporate sector directly or indirectly through collective investment schemes, like pension funds or mutual funds. Facilitating smaller fast-growing companies' participation in the public markets would result in accelerated wealth creation.

Evidence from the US shows that, publicly traded companies employ around one third of the population and represent 40% of GDP.[3] Initial Public Offerings (IPOs) allow companies to finance expansion thus supporting job creation. Data from the US market (IHS Global Insight) show that 92% of job growth occurs after a company's IPO.[4] In Europe, we observe that the number of employees grows on average 6% in the three years following an IPO.[5] In particular, companies that went public between 1998-2011 in Spain (both on the main market and the alternative investment market) increased their employment levels by 13.8% during the first year of listing which lead to an increase of 309.5% in the number of jobs during the first decade (going from 31,558 to 97,683 employees).[6] Similarly, as a result of listings on Nasdaq First North Growth Market between 2006-2012 the number of employees increased by an annual average of 36.5 % following their IPO, compared with 1.5 % for private companies on the Swedish market.[7]

The EU has recently recognised that sustainability and the transition to a safer, carbon neutral, and climate resilient economy will contribute towards long-term competitiveness in the European economy. Whilst there is overwhelming support for the move, it will require high levels of investment, a large part of which will have to be made by the private sector, more specifically by companies. Equity markets and efficient IPO mechanisms will be of utmost importance for the success of such a profound transformational process. According to estimates by New Financial "An additional €16tn in long-term capital could be put to work in the EU27 economy – more than double the current levels – with the average value of long-term capital per household rising from €58,000 today to €143,000".[8] Based on these benefits, promoting a well-functioning IPO market should be at the heart of the EU's policy platform.

The decline in small company IPOs in advanced economies



Source: OECD, 2016, 'OECD Business and Finance Outlook'

Statlink: http://dx.doi.org/10.1787/888933362512

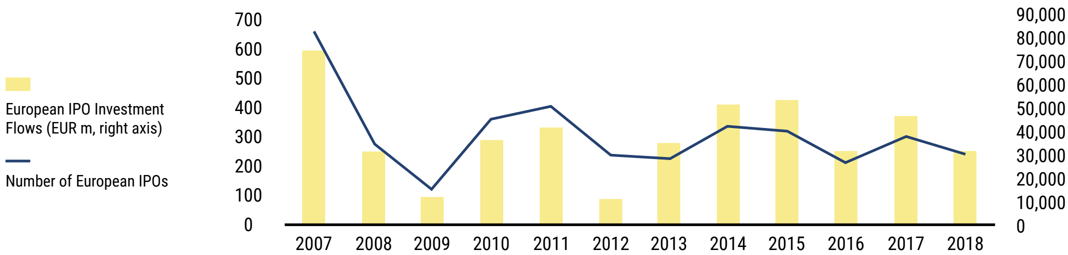
The long-standing trend of declining IPO markets

IPOs across the globe have been facing a structural decline over the past 20 years, be it by the number of corporate transactions, by amounts raised or by market capitalisation. For instance, the number of annual IPOs in Europe fell from 380 per year between 1997 and 2007 to 220 per year between 2008 and 2018.[9] The same trend is also happening in the US markets (from 300 to 150 IPOs per year[10]). A concerning aspect in this trend is the steep decline in smaller, growth company IPOs. Between 1994-2000 smaller IPOs (raising less than 100 million) represented 19% of all funds but in 2015 the corresponding number was only 13%.[11]

As noted by the European IPO Task Force already in 2015, the reduction in the number of IPOs is down to smaller companies not opting to come to the market. While IPO markets continue to function well for larger companies, they are becoming less and less attractive to smaller companies[12]. Smaller and younger companies have greater growth potential than larger companies, which means that European investors – and indirectly the wider public –lose the investing opportunity from the growth of these companies – which has an adverse effect on the wealth created for society.

It is also worth noting that the trend is global, evidence from the US shows that the number of small listed companies has declined across all industries[13], companies that do list are to a larger extent unprofitable[A] and more likely to have been acquired by a bigger company within three years following the IPO.[14] Listed companies are also becoming larger and older.[15] These trends do not imply that stock exchanges play a decreasing role in financing the economy. IPOs only represent a fraction of the total funding on equity public markets: so-called follow-ons (issuance of new shares by already listed companies) represent 70 to 80% of capital raised on our markets and have steadily grown over the past years.

Evolution of European IPO markets between 2007-2018



Source: FESE and WFE

[A] Change from 58 % unprofitable between 1980-2000 to 73% between 2001 and 2011

Why is this happening?

The low weight of external equity funding in companies' balance sheet and the decline in the number of IPOs is due to a combination of factors:

- Lack of liquidity - fewer institutional investors are willing or able to invest in smaller companies on stock markets. Retail investors are blocked (by regulation and intermediators) from investing in smaller issuers;
- Regulatory disincentives - Increasing administrative and financial burden linked to the public listing and public offering;
- Increasingly companies tend to grow through mergers and acquisitions.
- Regulatory minimum trading volume requirements for public investment funds, limiting their possibility to invest in small- and micro-cap stocks;
- Documentation requirements for public fund managers, preventing them from entering into small- or micro-cap investments;
- Regulation strongly restricting the possibility for retail investors to get research or active advice about single stock investments;
- The decline of free research on small- and micro-cap companies due to the new industry structure under MiFID II, leading to small- and micro-cap companies increasingly paying for research or corporate access, as otherwise fund managers will not receive information about them;
- Declining number of active fund managers due to MiFID II, which brought a lot of pressure for consolidation in the fund management industry;
- Insecurity about the success of the IPO process, due to the above mentioned factors and specifically the decline of active fund managers, generating concerns about high costs with uncertain benefit of a successful equity raising;
- Lack of an equity culture that makes company founders reluctant to open up the shareholding structure and involve external investors;
- The increasing availability of alternative funding sources – especially the more active presence of global companies on the acquisition market as this makes for less interest in going public;
- The ecosystem that traditionally serves the IPO candidates, especially the active sales force of intermediaries - broker-dealers - has undergone change due to regulatory impacts;
- Companies are not listing because of the sometimes excessive and unjustified scrutiny that puts them at a competitive disadvantage vis a vis non-listed companies;
- The generally low (and lower compared to the US) valuation level of European equity markets due to all the relevant negative factors mentioned in this report;
- The historically low level of interest rates for the longest period ever together with the favourable tax treatment of debt are contributing factors to the decline in IPOs as it makes it easier for companies to borrow and/or attract investor mentors from private equity managers.

Adverse regulatory impact disincentivising companies from listing is a major consideration

Recent financial regulatory initiatives, especially those launched in the aftermath of the 2008 crisis, have had the effect of:

- Creating a 'one size fits all' regulation for companies and markets
- Driving up costs for all companies looking to go public. As the majority of these costs are fixed regardless of the size of the issuance this reduced the supply of small and mid-cap companies in particular;
  > *Disincentivising investment in smaller companies and in equity overall;*

  > *The move to passive investment with investors de-risking by tracking indexes rather than using active investment funds;*

  > *Shifting the economics of trading shares away from long-term investing and towards more trading of larger company shares, thus making the IPO process unattractive for smaller companies;*

  > *Eroding the local ecosystems of smaller brokers, analysts and advisers catering to the needs of smaller companies and investors. This has been the case, for instance, of MiFID, I and II, and MAR as both favoured blue-chips while evidence suggests that there may have been unintended consequences for small brokers and SME markets as liquidity has dried up and corporate valuations have fallen.*

Costs of going and being public

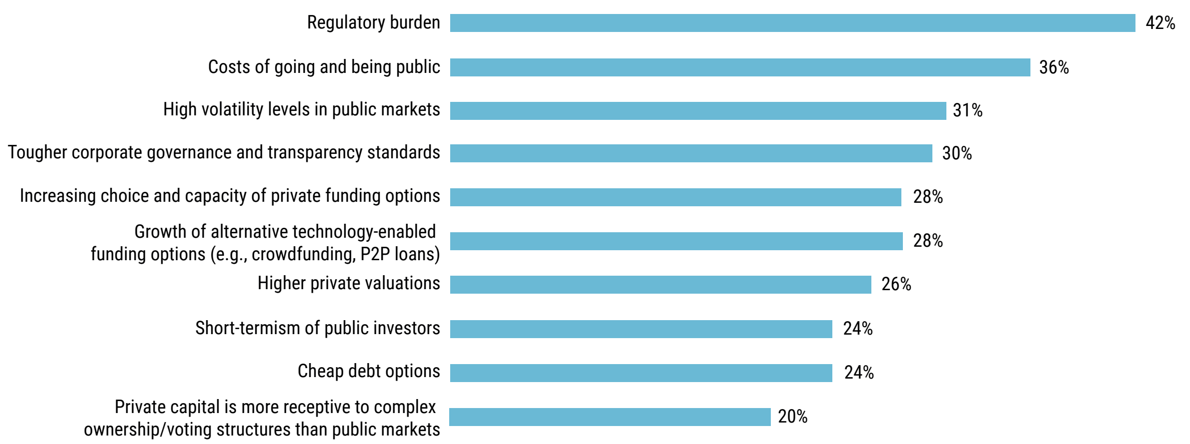
As shown in the graph, 36 % of executives list the cost of going and being public as a cause of the decline in popularity of equity markets. Companies measure costs both in absolute terms and in relation to available alternatives. The fixed cost of going public includes: bank fees, legal fees, listing sponsors, auditing fees, cost for prospectus and material and exchange fees.

The overall cost varies considerably among companies and countries and depends significantly on how complex a business is and the amount of capital it is proposing to raise as part of the IPO. FESE has estimated the costs to be approximately:

- *10 to 15% of the amount raised from an initial offering of less than EUR 6 million:*
- *6 to 10% from less than EUR 50 million*
- *5 to 8% from between EUR 50 million and EUR 100 million*
- *3 to 7,5% from more than EUR 100 million*

The ongoing costs of being listed includes costs for sponsors, brokerage services, exchange listing fees and sometimes independent research providers. Companies also consider the costs in terms of the complexity of the process, the time it requires from the management team and risks involved in the process.[16] It has been highlighted that the biggest costs are mostly hidden, including the cost of regulatory compliance. However, the cost of being listed should be compared with the benefits, including the exposure and possibility to raise significant funds through secondary issuance, where the marginal cost of raising capital is low. Moreover, a lack of awareness about the benefits of listing can skew companies' cost-benefit analysis when considering going public.

What may cause public equity markets to decline in popularity?



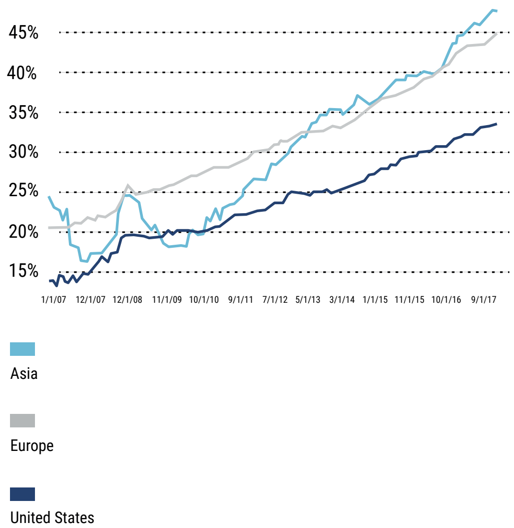
PwC, 2019, The Economist Intelligence Unit, 'Capital markets in 2030: The future of equity capital markets'.

The erosion of IPO eco-systems

IPOs depend on a complex and delicate ecosystem of important players: exchanges, brokers, banks, advisers, analysts, auditors, lawyers, etc. who must all come together to serve enterprises and households in different ways to benefit the economy through financing saving and risk management. Traditionally, the various players which make up the ecosystem of brokers, analysts and advisers that cater to the needs of smaller companies and investors were incentivised to invest time and resources into building the demand for smaller IPOs.

In the old days, spreads for trading SMEs were significantly higher, leaving a margin to be earned for brokers. With lower tick sizes there is now less money for the broker to earn. Regrettably these services are disappearing, which has consequences for the number of IPOs in Europe. At the same time, on public markets, investors have moved out of equities and into alternative asset categories and equity investment has increasingly moved from small to large and from active to passive investments.

Percentage of assets in passive equity funds



Source: Morningstar Direct Asset Flows

Taxation issues

Companies measure the cost of equity finance also in terms of the tax treatment they receive. The debt-equity bias present in most EU member states, is based on the fact that interest payments on debt are subject to tax-relief, while equity is often subject to additional taxes. This disincentivises companies from choosing equity as a source of financing and instead they opt for higher levels of debt; such tendencies are reinforced in the current circumstance of historically low levels of interest rates. From an (retail) investor perspective, also the lack of a European framework on withholding dividend tax for cross border investment is a pending issue.

The increasing availability of alternative funding sources

14% of global assets are now placed in private markets, while a few decades ago these investments were comparatively at a very low level.[17] Private markets have grown substantially in scale and accessibility and now competes much more acutely with the public market. Global private markets assets under management rose more than fourfold between 2000 and the middle of 2016 to $2.5 trillion[18], a record high. Although still small relative to the $36 trillion market capitalisation of MSCI All-Country World public equity index, private markets have grown 2.5 times faster over this period. An important development has been the ability of companies to raise sums of money privately that previously would not have been possible outside of public markets. The ability to raise such huge sums privately defers one potential need for a public listing.

At the same time, the cash generation capacity of the largest companies increased dramatically in recent years[19] and also increased their activity in the merger & acquisition market (M&A). However, this larger role of the M&A market may increase the imbalance and the dependence of the economy on global enterprises (like Apple, Google etc.) and also decreases the diversity and job creation capacity of the private sector. On the other hand, research by PwC and the Economist Intelligence Unit show that 70 % of company executives agree that the most successful companies would still choose to go public at some point in their life cycle.[20]

What needs to be done?

> Create an equity culture in Europe

Europe is heavily bank-based and the lack of an equity culture is a major barrier to developing the SME IPO market. The vast majority of company founders/managers share the misbelief that they would lose control over the company when opening up the shareholding structure and also weaken the competitiveness of the company when applying the transparency obligation of a public company. However, public equity funding can preserve the independent growth for a company and allow original shareholders to manage control of the company and the transparency of a company increases the business trust and builds its reputation/ brand. A comprehensive programme is needed at EU level to advocate these benefits. Components of a successful equity culture includes investor liquidity, confidence and participation (including access to markets) and regulatory incentives (and the lack of burdensome disincentives). Some recent regulatory developments, including MiFID II requirements, have made it harder for or discouraged retail investors from participating in capital markets.

Analysis by Oliver Wyman over 2014-2018 shows that smaller, regional exchanges play a particularly important role in access to equity finance for smaller companies. Large European exchanges (London, Frankfurt, Madrid, Amsterdam and Borsa Italiana) dominate the market for European IPOs by value. 67% of total European IPO activity by value took place on these five venues over 2014-2018 (including their alternative markets like Euronext Growth and London AIM). By contrast, the same exchanges hosted only 59% of the number of smaller IPOs (companies with less market capitalisation than USD 200 million) despite having dedicated SME markets. Smaller, regional exchanges across Europe host a larger share of IPOs for smaller companies as these companies are more likely to be local and seek investors more familiar with their business. This demonstrates that the diversity of the European exchange landscape and strength of smaller, regional exchanges is important for European companies' ability to access equity markets. The EU needs to embrace this and create the right balance to support and encourage companies to consider listing as the right choice for funding.

European Commission President Ursula von der Leyen announced that she will propose an SME strategy that focuses on their access to the capital markets. To this effect, she vowed to "create a private-public fund specialising in Initial Public Offerings of SMEs, with an initial investment from the EU that could be matched by private investors".[21] These initiatives, which could take the form of small IPO investment funds/vehicles with the support of InvestEU, are most welcome. If successful, the proposal could change the amount of liquidity available for smaller issuers and create a different ecosystem. It could encourage new intermediaries and networks of intermediaries, investors willing to co-invest and raise awareness amongst pre-IPO companies of the benefits of listing.

The European IPO Task Force as a collective of industry experts is ready to support EU policymakers in their endeavours and believe that this report will provide the basis and understanding of what requires focus.

1. Improving IPO ecosystems for companies and investors by creating a more flexible regulatory environment for listed small and mid-cap companies

1.1 Levelling the playing field between private and public companies

The first step for aspiring entrepreneurs is to ask for financing from family and friends, the bank or business angels. Venture capital funds can provide financing at a later stage if the company is growing rapidly and requires funding of a different scale. Traditionally, venture capital funds have been the step before a company eventually goes public on the stock market which then provides an opportunity for early investors to sell their equity and realise the gains. However, in recent years this has changed as there is an abundance of capital in private equity, partly due to the low interest environment and partly due to the favourable tax treatment of debt vs equity. Many companies can therefore benefit from financing from private equity for longer and the valuations of private companies are ever increasing.

The private equity industry (venture capital, growth, buy-out, etc.) has grown a lot over the past decade, in terms of assets under management (from EUR 377 billion in 2007 to EUR 640 billion in 2017), investments and money raised.[22] This competition to public equity funding is all the more important as some private companies may be in a position to use debt to finance their activities, which does not exist on IPO markets. In the past, companies that were looking for bigger investments would eventually list as more funds can be raised on the public market but, as private equity has scaled up, listing tends to be pushed to a later time. While listing can still happen at a later stage, as it remains one of the main exit routes for private equity funds (along with trade sales); IPOs have been the least used exit route for a long time. The declining number of IPOs has structural reasons which we address below.

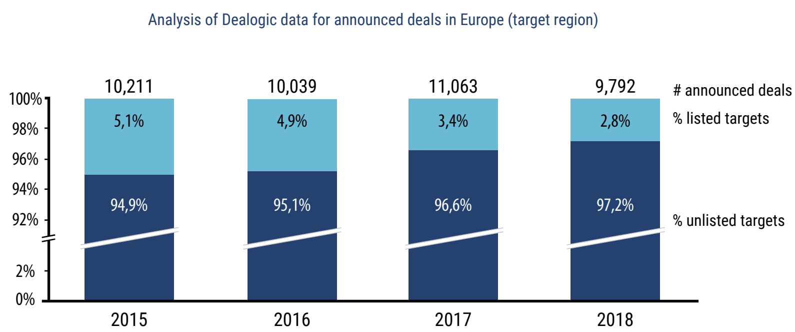
A. **Alternative financing is associated with less costs** - On the demand side, companies have access to lower cost alternatives, especially private equity. However, if private equity companies "load" the debt on companies that decreases the shock-absorption of companies and creates risk for their survival. With the growth of alternative funding, the costs associated to these processes are becoming a vital part of the financing decision. More assets seem to be allocated to private equity funds. In addition, the share of companies being taken over before listing has increased significantly, as displayed in the below graph.

B. **A decreasing interest in small caps -** There has been a decline in buy-side interest in SMEs, notably in the European Union. Market participants' business models are no longer adapted to SMEs (equity research, asset managers investment policies etc.) making it difficult for small caps to attract interest from investors. The decrease in analyst reports is an indication of this increased lack of interest. For active fund managers, additional barriers include documentation requirements for stock investments and restrictions on minimum trading volumes of investments in public funds imposed by regulators.

C. **Suboptimal features of the IPO process itself -** There is a growing importance of private equity in the earlier stages of financing. Private equity funds are focused on valuing the ability to entirely exit from an investment, instead of being partially locked into their investment and subject to public markets price fluctuations (unlike IPOs).

Analysis on company takeovers

Over the last years, the share of companies being taken over before listing has significantly increased



Source: Dealogic, Olivier Wyman analysis

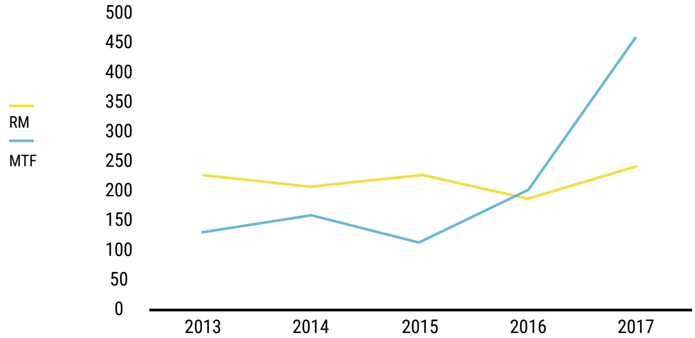
Concerns have been raised in relation to the rise of private equity as these investments are open to few market participants, in particular, retail investors cannot participate in these types of investments. While, it should be noted that private individuals can benefit from exposure to private companies through e.g. their pension fund, it is normally not possible to directly invest in a company before it goes public. If the trend continues, there is a risk that retail investors are excluded from directly partaking in the growth of emerging companies. As noted by New Financial, there is a 'disclosure gap' between private and public companies which could be addressed by raising the reporting standards for large private companies.[23] A green paper published by the UK government in 2016 concluded that "increasing numbers of large businesses are choosing to operate as private businesses. In doing so, they are excluded from the higher levels of public scrutiny and formal corporate governance discipline associated with being traded on a public market".[24] However, regulators should not try to reduce this gap by lowering disclosure standards and loosen investor protection in public markets as this is not the cause of the capital formation shift toward private investments.[25]

While it has traditionally been argued that the ownership structure of private companies means that the owners do not require the same levels of information and security (as shareholders of public companies) since they are controlling the company, this is starting to change as it is out that stakeholders in a company are broader than just the ownership and include employees, customers suppliers and pension fund beneficiaries as these are all affected when a company fails. Another argument is that society has an interest in companies being well run and that with the privilege of limited liability should come a responsibility of good governance.[26] In the UK, this has been addressed by adopting requirements for private companies to follow codes of conducts of corporate governance, for example the Wates Corporate Governance Principles for Large Private Companies developed by the Financial Reporting Council.

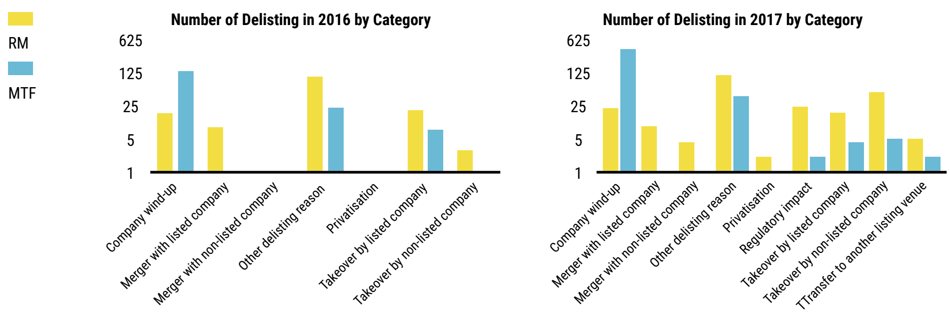
It should be noted that the tax-treatment of debt and the cost of being listed favours privatisation of companies. The below graphs show the number of de-listings between 2013 and 2017 on regulated markets and multilateral trading facilities and the main reasons for delisting.

In this environment, many companies do not consider going public as an alternative for their funding because there is no supply of public equity finance for a smaller issuer or other means of funding are considered more attractive or due to a lack of awareness of alternatives.

Company delistings from public markets 2013-2017



Delistings



Statistics produced by FESE

1.2. "Do Small First" in all EU financial regulation affecting small and mid-cap listed companies

In addition to the availability of private capital, companies are less inclined to list due to high fees and the extension of requirements they would become subject to once listed on the public markets. Furthermore, listed companies sustain ongoing costs for remaining public. Even-handed, proportionate and well considered disclosure requirements enable investors to make informed investment decisions and are necessary for the well-functioning of markets. Any solutions to reduce the costs and administrative burdens involved in listing must be consistently coupled with ensuring investor protection, for example through the provision of sufficient, understandable, comparable and material information on a company to prospective investors.[27] However, the types of applicable requirements need to be well-suited to the size of the company following a proportionate approach. Examples of a proportionate approach include corporate governance codes developed specifically with smaller issuers in mind in France by Middlenext and in the UK by Quoted Companies Alliance. Moreover, where there are wider social or economic reasons there should be a level playing field between equivalent public and private companies in terms of the level of disclosure requirements they are subject to.

A holistic approach to legislation should always be taken to avoid overlapping requirements for companies coming from different policy fields. Specific impact assessments should be undertaken looking at the effect of legislation on smaller public companies. The benefits derived from a regulatory change affecting large companies often outweighs the very real detriment to smaller companies. The net benefit is taken as a reason to implement a wholesale change that further exacerbates the plight of smaller public companies. The European Commission should be charged with conducting a segmented approach to public markets for the purpose of such impact assessments between large and smaller issuers.

As an overarching point, the European Commission should continue to use impact assessments for all new legislative proposals and consider the cumulative effect of overlapping legislation as was done in 'call for evidence'[28] exercise launched in 2015 and the recent fitness check on public reporting by companies.[29] However, throughout the EU legislative process, as changes are made and proposals submitted, it is equally important to continuously assess the impact of new proposals. The impact assessments[30] conducted by the European Parliamentary Research Service and the European Council Oversight Unit is therefore a very welcome best practice that should be encouraged.

The review of the Prospectus Directive aimed to make it less costly for businesses to raise funds publicly, review regulatory barriers to small firms listing on equity and debt markets and support the listing activities of small firms through European advisory structures.[31] The new Prospectus Regime should ensure that SMEs no longer have 200-300 pages prospectuses, but instead can present relevant information to investors with greater flexibility, more incorporation by reference and making use of the full potential of technology for displaying the prospectus disclosures. This will make prospectuses lighter and thus add more value for both investors and issuers. However, the jury is still out on whether a summary prospectus would facilitate investors' life as it cannot be used alone for liability action. In other words, the issuer cannot be held liable based on information that is not provided in the summary prospectus but included in the main prospectus document. Being less prescriptive over the content of smaller issuers' prospectuses could lead to more relevant information rather than compliance with a long list of detailed universal requirements which results in information that is not relevant for an informed investment decision.

Further alleviations would be beneficial to simplify the disclosure requirements for secondary public offers. In particular, in relation to disclosures of risk factors, as issuers are currently required to disclose the same information on several occasions, while it should be deemed that the information is known to the market (due to other legislation such as the Transparency Regulation). Preparing a document that addresses all types of risk factors creates significant costs for issuers. We would recommend conducting a comparative study on the practical experiences with filing requirements currently faced by small listed companies on MTFs across the Single Market as a basis for a potential alleviated regime. The changes to the Market Abuse Regulation (MAR) in relation to inside information for companies listed on SME Growth Markets are welcome but there are further measures that could be considered in striking a balance between reducing burdens and maintaining market integrity. There are a number of examples where additional bureaucracy and additional compliance risks for issues have been created by MAR with no obvious benefits for investors. Examples include the duty to react on rumours related to inside information, the level of detail of insider list, requirements in relation to managers' transaction reporting and the very high level of sanctions.[32]

MiFID II introduced a harmonised minimum tick size regime covering equity and equity like instruments. The purpose was to address a race to the bottom in tick sizes for blue chips.

However, the requirements apply equally to SMEs traded on local exchanges and based on these requirements, there have been signs of market quality deteriorating as tick sizes are now set too wide in some markets, whereas in others they are too narrow. Moreover, in relation to tick sizes for IPOs of all sizes, as the tick size regime is centralised under ESMA according to MiFID II, trading venues have experienced issues in relation to the determination of the most relevant market (which for an IPO should naturally be the venue of listing but this has not always been the case due to technical issues in relation to the ESMA database in this regard), which has led to tick sizes being set arbitrarily thus negatively affecting trading and price formation. As tick sizes should not be a hindering factor in keeping trading in SME shares of high enough quality, the market operator should be allowed to determine the tick sizes itself for this segment of shares.

The settlement arrangements for illiquid stocks under Central Securities Depositories Regulation (CSDR) should be reviewed as liquidity providers are likely to find that after its introduction the fining and cash compensation regime for late delivery will no longer make it commercially viable to provide such liquidity for these stocks. Companies with no liquidity provision will determine that there is little point in being on a public market if there is no facility for price formation and for their shares to be traded effectively.

1.3 Improving the attractiveness of SME Growth Markets

Many exchanges have specialised markets that allow SMEs across Europe to access capital markets. On these markets, there is a continuous dialogue among various participants within the ecosystem about improving the rules tailored to local needs. It is important to keep the aim of finding the best balance between maintaining a liquid and trusted market with reduced burdens for issuers and adequate levels of investor protection. These markets, for those reasons, should retain a certain level of flexibility whilst ensuring efficiency and integrity. EU policies can make a difference in preventing a further loss of the local and regional ecosystems by sustaining the full spectrum of players serving smaller companies and their investors. They also need to deliver a comprehensive strategy on how to boost equity and non-equity financing at all stages of the funding escalator. [33]

SME Growth Markets are a welcome initiative with great potential to develop an ecosystem across the EU that benefits smaller issuers, enabling them to raise money, grow, create employment and wealth for investors and wider society. However, the concept has not been clearly defined. The ESMA Securities and Markets Stakeholders Group (SMSG), in its own initiative report, 'Access to Public Capital Markets for SMEs' called upon the European Commission to present well-defined, measurable parameters for success for the SME Growth Market concept. This was suggested so that the European Commission could accurately assess whether it has effectively harnessed the potential SME growth markets and whether they are truly fit for purpose in the European financial ecosystem.

Policymakers recently agreed changes to requirements applicable to companies listed on SME Growth Markets. These changes are in relation to the Prospectus Regulation (allowing for a simplified procedure for companies that wish to scale up to the main market) and MAR (removing some stringent obligations related to inside information). In line with the recommendation of the Next CMU High-Level Group, we would support further alleviations for SME Growth Markets. We consider that the threshold for companies should be raised to on average market capitalisation of EUR 200 million to EUR 1 billion. We also support the recommendation to allow special segments of regulated markets to benefit from SME Growth Market status and simplifying access to both SME Growth Markets [34] and regulated markets.

1.4 Improving the provision of research on small and mid-cap companies

Since January 2018, MiFID II has accelerated the reduction in equity research focussing on smaller issuers. 334 European smaller issuers lost coverage completely in 2018, 91% of which only had 1 analyst before the implementation of MIFID II.[35] Now, most small and mid-caps are covered by 0 to 1 analyst whilst large caps benefit from much wider coverage and better visibility to investors. Pre-MiFID II, research was supplied as part of a bundled service, paid by execution fees. Research post-MiFID II is required to be unbundled and priced separately from execution of financial instruments.

The 2019 CFA Institute survey on the first perceptions of the impact of MiFID II rules on research shows that sell-side surveyed professionals believe that the legislation has created unintended consequences on quality and quantity of research, especially from SMEs. In particular, they feel that research quality of small and-mid cap stocks has shrunk as a consequence of MiFID II rules. Nevertheless, buy-side respondents believe that research quality and coverage is pretty much unchanged.

A similar study, the QCA/Peel Hunt Mid and Small-Cap Investor Survey published in February 2019 showed that 62% of fund managers reported that less research is being published on small and mid-caps, with a further decline expected, and 80% of investors expect there to be fewer broking houses in the next 12 months as a result of MiFID II. 63% of investors think that MiFID II has had a negative impact on the liquidity of mid and small cap stocks with 42% of companies in the same survey agreeing.[36]

Research by CFA Institute show that the main factor impacting investors' interest in SMEs is a lack of liquidity, followed by lack of research coverage.[37]

Research is necessary to allow investors to fully understand the companies they are looking at and investing in. While the requirements for research to be paid independently may work well for blue chips, it is intuitive that investors are less prepared to pay for research on companies they may have never heard of. It is easy to see that a vicious circle of lack of investments in SMEs may be perpetuated where research requires payment and investors are not prepared to pay for research on companies, they do not believe themselves to be interested in. Moreover, equity research fuels liquidity and a lack of research makes SMEs' shares more illiquid and thus less attractive to investors.

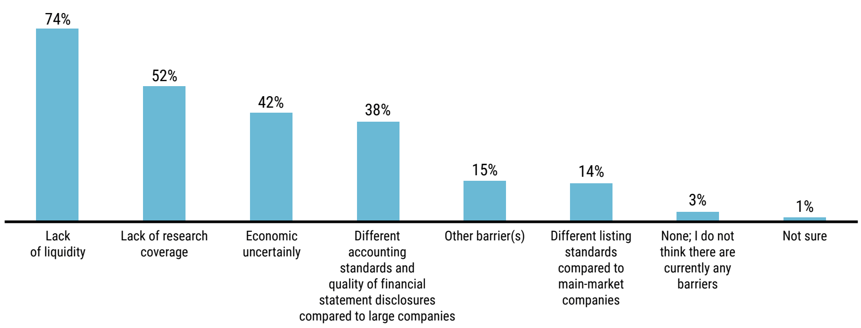
A growing number of SMEs are therefore paying independent research providers to write research and take the initiative in approaching investors directly. However, this is challenging due to potential conflict of interests and a lack of recognition and coverage limitations due to budget constraints. There are countries, like Hungary where the stock exchange itself launched a program to cover the costs of SME research coverage and the first results suggest that it can create additional liquidity for the listed SMEs. A Pan-European program should be launched to cover the costs of research coverage based on the lessons learnt from these pilot programs. A possible additional way to improve liquidity of SME shares would be to establish user-friendly platforms for analysts to share their reports on. Retail investors should also have access to such a platform.

As a result of unbundling rules, fund managers are prevented from accepting research on small companies provided by brokers for free. The rules should be amended to allow brokers to send SME-research reports to fund managers without having to establish a research contract with them. In doing so, a threshold could be established for what should be considered an SME.

1.5 Reducing the cost of supplementary services faced by issuers

Besides the missing research coverage, the other major barrier to SME IPO market development is the low secondary market that smaller issuers' shares face after the IPO. In comparison to large issuers, smaller issuers cannot build up a wide shareholder base and large free-float that would be sufficient for a liquid secondary market. The weak secondary market trading is accompanied by high liquidity risk and leads to lower valuation and underperforming share prices. It creates a vicious circle where investors are less willing to invest in IPOs (or will only do so at a high discount) and in parallel IPO candidates are discouraged as well. Liquidity provision arrangements with investment service providers – market making - are necessary to increase and maintain efficient liquidity. The problem is that without external financial support it is difficult or not possible to build up a sustainable business case for market making. European measures to promote secondary market liquidity should not counteract nationally established liquidity mechanisms. Moreover, as mentioned above issues in CSDR regarding settlement of illiquid stocks needs to be addressed to encourage more liquidity provision.

What barriers, if any, currently exist that impact investor interest in Small and Medium Enterprises (SMEs)?



Source: Dealogic, Olivier Wyman analysis

The European IPO Task Force in 2015 suggested the establishment of an EU industry expert group of advisers that would develop proposals on how to reduce the cost of supplementary services faced by issuers. We welcome the fact that the European Commission President Ursula von der Leyen has included measures which aim to achieve this in her political guidelines for the next European Commission. The President rightly recognises that SMEs are "the backbone of our economy" and their ambition to make "small businesses become large innovators" is most welcomed.

Creating a private public fund that would specialise in IPOs of SMEs has long been called for by market participants and could potentially be a game changer for European equity markets. The European Commission should consider mandating the proposed EU IPO fund to provide capital to companies. It could also be mandated to:

- *Support equity research on SMEs with the use of subsidies, to promote their visibility towards both institutional and retail investors;*
- *Stimulate SME Growth Markets with repayable loans to cover SMEs' IPO expenses, repayable by the SME after it has raised funding on the public markets. This would help SMEs cover pre-IPO costs for roadshows and advisory services (audit, equity, communication, etc..);*
- *Provide secondary market liquidity by lending stock in companies in which it has an investment to smooth trading and prevent volatile share prices when there is a shortage of deliverable stock. This could provide greater confidence for investors and thus help create further liquidity.*

Inspiration could be drawn from a programme launched by the Budapest Stock Exchange in December 2017 to support the liquidity of the mid-cap companies. The program consists of two elements:

- *Research coverage*
- *Market making*

The applying brokerage companies (or banks) needed to provide both elements for the selected companies parallel in order to get the financial subsidy from the stock exchange. The program was launched as a pilot for one year, but based on the positive results, the stock exchanged decided to continue it in 2019 as well.

Moreover, investors usually have a minimum investment size of for instance EUR 5 million and there are often limits to how big a share of a company they can own e.g. 10%. In addition, they are restricted from participating in more than 10% of the free float. This means that a company must be EUR 50 million with a sizable free float before a small-cap investor can get involved. Any private public fund should therefore be focussed on making a multitude of small investments to overcome this gap. It should also be able to invest in further issues after IPO and, as above, smooth the market by lending stock as appropriate.

The European Commission should also explore measures to help bridge the gap between private and public equity to smooth the company's transition from one to another. For example, cross-over funds can act as a financial instrument to remedy the valuation mismatch between public and private equity investors prior to a company's IPO. These instruments are investment funds that hold both public and private equity investments and build on private equity investors' education to facilitate portfolio exit in greater proportions, while boasting the patience expected by public investors, leading to improved valuation and better post-IPO journeys. Cross-over funds have been in use in the US for some time and are starting to emerge in Europe with some sector-specific funds.[38] Companies' private valuation under cross-over investment funds, are expected to be more in line with that of public investors, leading to a more correlated valuation of their share price with less risk of a devaluation for the companies concerned. This would foster convergence between public equity and private equity markets. A cross-over fund could be helpful in that it could anchor investment during the IPO process and improve after market liquidity. However, it is important to ensure that a private public fund does not replace private investments.

1.6 Providing targeted assistance and proportionate requirements for smaller markets to reach their full potential

For smaller markets, the local dimension, is especially essential to cater for the specific needs of companies which are mostly SMEs. Regulators and policymakers should explore how to derive full benefits from an EU integrated diversity of national eco-systems, particularly in areas such as market infrastructure, taxation, and supervisory coherence. In general, incentives should be targeted for SME Growth Markets and to support SMEs listed on regulated markets. As mentioned, the objectives of SME Growth Markets need to be defined along the lines set out in the ESMA SMSG own initiative report – Access to Public Capital Markets for SMEs.

While we very much welcome the Level I measures adopted by the EU co-legislators to encourage SME listings (amending MAR and the Prospectus Regulation) and the Level II changes to the Delegated Regulation under MiFID II, more needs to be done. EU regulators should run a comprehensive assessment

Hungarian example

When developing the SME strategy of the Commission, inspiration can be drawn from several excellent initiatives in Hungary on how the government supports the capital market development via targeted funding solutions specialised mainly for SMEs.

The structure is built on a 4-pillar system where:

1. The stock exchange operates a dedicated market for the SMEs called Xtend Market with lowered listing requirements (this is operated as an MTF)
2. The government supports the listing by covering the one-off listing cost and co-investing in the IPOs
3. There is a scheme to support the secondary market liquidity via market making and research coverage
4. There is a capacity building program for potential issuers

In order to keep this structure working the government has four types of financial support to the market:

- There is a Stock Exchange Development Fund that acts as a co-investor pre-IPO or during the IPO of SMEs.
- There is a dedicated Grant Fund to partially cover the costs of the IPO for SMEs – this is managed by the stock exchange itself and covers up to 50% of the costs related to the listing (legal advice, preparing the prospectus, sales and PR costs as well).
- There is a funding program to subsidise the market making and the research activity of the brokerage companies.
- Subsidies to the IPO candidates cover the cost of participating in the ELITE Program, a capacity building program organized jointly by the BSE and the London Stock Exchange.

of the cumulative impact on markets of the various legislative files, taking into account that it might differ based on the size of the markets.

It is key to boost the development of smaller capital markets where most companies are SMEs and the investment gap remains broad. Capital markets in Central and Eastern Europe region (CEE) face different obstacles in their development and integration, and different regulatory standards and barriers compared to Western Europe. For example, in the CEE region,[B] the average stock market capitalisation accounts approximately for less than 20% of GDP as compared to an average of 75% of GDP in the EU28. The main challenges faced by these markets, are:

- *Lack of proportionality and resources;*
- *Lack of an equity culture, leading to low retail investor demand;*
- *Lack of attractive stocks (few top performers, corporate governance issues, etc.) paired with a lack of harmonisation of investments rules;*
- *Lack of post-IPO liquidity which affects the quality of pricing and leads to low valuations results.*
- *Lack of quality capital, especially related to innovation and intangible assets (research, skilled workforce, financial education, advisory services, etc.) - markets are dominated by SMEs without an adequate ecosystem to cater for their needs, especially from an investors' side;*
- *Impediments in the post-trade infrastructure;*
- *Lack of private pension schemes and missing capital market orientation;*
- *Low weighting market in international portfolios due to the low local market classification results, lack of research coverage and of trust of the local legal framework.*

Moreover, a survey of 263 investment professionals performed by CFA Institute in early 2018 identifies issues preventing local capital market developments. In all member states, 'scarce supply of listed equity/debt securities is listed as a key concern, followed by low demand from retail investors.

[B] This includes: Bulgaria, Croatia, the Czech Republic, Hungary, Poland, Romania, the Slovak Republic, Slovenia, and the three Baltic countries.

Issues preventing local capital market development

	TOTAL (n=246)	BULGARIA (n=17)	CYPRUS (n=16)	CZEC REPUBLIC (n=23)	GREECE (n=32)	HUNGARY (n=25)	POLAND (n=78)	ROMANIA (n=41)	SLOVANIA (n=13)
Scarce supply of listed equity / debt securities	50%	76%	50%	70%	34%	76%	24%	68%	69%
Low retail investor demand	37%	35%	38%	30%	47%	40%	32%	44%	23%
Administrative burdens that discourage companies from seeking public listings	29%	18%	13%	26%	13%	16%	51%	24%	15%
Low institutional investor demand	26%		63%	9%	34%	32%	22%	17%	54%
Low level of investor protection	17%	35%		17%	28%	4%	19%	10%	15%
Uncertainty on the impact of certain EU regulations and directives (e.g. MiFIR/MiFID II)	11%	6%	13%	9%	6%	12%	17%	12%	
Other	11%	6%		13%	9%	4%	14%	12%	15%

Question: What issue. if any prevent the development of your local capital market? Please select the top 2 issues.

Statistics produced by CFA Institute

The availability of extensive EU financial resources (non-refundable grants and low interest rate loans) for example in the CEE region has a substantial crowding-out effect and it makes the capital market funding solutions less competitive.

For smaller markets, the regulatory burden can sometimes be overwhelming. More precisely, the 'one-size-fits-all' model, mostly used in the context of EU level legislative frameworks, is disproportionate for smaller markets and brings excessive requirements for services providers, thus making the overall market uncompetitive and unattractive for all market participants. For instance, due to the full application of MAR to MTFs, issuers on these specialised markets need to apply the same requirements as the main markets. On certain occasions, regulators introduce additional requirements (on top of the EU framework) or opt for the lowest possible level of freedom a certain EU directive or regulation allows with the reasoning that tighter regimes ensure a higher degree of investor protection. One such example is the reluctance of some regulators to set higher than the minimum threshold for offerings that are exempted from the requirement to publish a prospectus under the Prospectus Regulation. This discourages smaller companies who face rising compliance costs and hence prefer not to list or to de-list and resort to private equity.

Therefore, we encourage EU regulators to:

- *Run a comprehensive assessment of the impact of the various legislative files which might differ based on the size and maturity of the markets; implement disciplinary regimes that match the resources of participants.*
- *Consider forms of technical assistance to support the implementation of EU laws at national level. Such support should have a very practical dimension (e.g. take the form of roadmaps and instructions) and should be tailored to specific needs of the countries concerned. This would help mitigate the regulatory burden and could enable focussing more on business, rather than on the implementation of the EU legislation.*
- *Propose longer time periods for transition and implementation to give more time to issuers and other SME Growth Market participants to get ready for the changes and to implement them.*

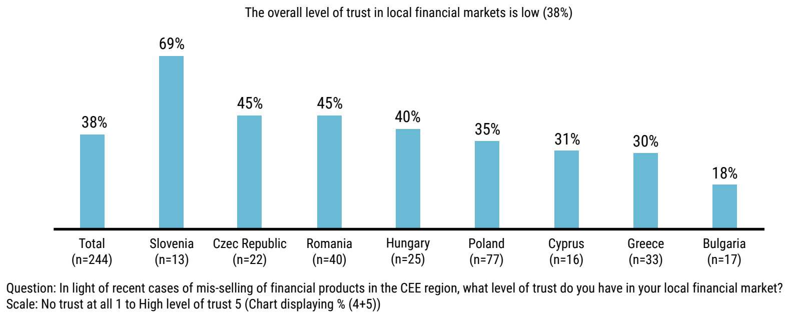
In addition, it should be noted, that in smaller markets, the extent of new regulation coming into place in recent years has led to a climate where companies ask 'what will come next' i.e. the cost of complying with the requirements of being listed is not only assessed in terms of current regulation but also taking into account the cost of complying with potential new requirements. There is thus a significant opportunity cost created by the lack of regulatory certainty.

Cases of mis-selling of financial products have in many cases led to a low level of trust in capital markets (as seen in the graph below). Consumer protection is an important factor in rebuilding trust and ensuring the development of capital markets. It requires a robust legal framework and competent government institutions to implement and enforce it. Regaining trust in the market requires setting an example of quick and efficient prosecution of embezzlers and other wrongdoers.[39] Nevertheless, it should be noted that most surveyed investment professionals consider that their local market provides higher standards of investor protection compared to five years ago, which is a step in the right direction.

The CFA Institute also conducted a Nordic Capital Markets survey, showing that a multiplicity of reasons lie behind the insufficient development of Nordic markets. In the Nordics, survey respondents quote the most important barriers as: administrative burdens that do not incentivise public listings, scarce supply of listed equity, low demand from retail investors and uncertainty of the impact of some EU legislations. Low levels of education and awareness of the benefits of investing in public markets was another issue stressed by respondents.

Following the recent rise of passive investments, the importance for listed companies of being included in indices has grown exponentially as this provides many more investment opportunities. In the same vein, the classification of markets plays a key role as it determines the nature of the investment opportunity. However, the classification of countries according to their development does not always reflect that certain conditions might be fulfilled through their participation in the Single Market and the application of the EU legal framework. In certain cases, rather than classifying countries separately, a regional approach could be considered. This would be helpful for many smaller markets including in the Baltics and Central and Eastern Europe.

Level of trust in local financial market



Statistics produced by CFA Institute

Recap of recommendations

1. Improving IPO ecosystems for companies and investors by creating a more flexible regulatory environment for listed small and mid-cap companies

Recommendations	Key stakeholders
Adopt proportional requirements for smaller companies	
Establish a level playing field in requirements applicable to private and public companies, as well as an appropriate level of investor protection which includes a European collective redress mechanism.	European Commission
Discuss EU financial regulation following a 'do small first'-mindset to avoid a 'one-size-fits-all'-framework e.g. MAR and Prospectus requirements should be simplified to decrease the administrative costs of doing an IPO, while ensuring relevant information is disclosed in a reliable and proportionate manner.	European Commission
Continuously undertake specific impact assessments looking at the effect of legislative proposals on smaller public companies throughout the legislative process.	European Commission, European Parliament, Council
Promote SME Growth Markets	
Raise the threshold for companies for qualifying for SME Growth Markets status to EUR 1 billion market capitalisation.	European Commission
Allow special segments of regulated markets to benefit from SME Growth Market status and simplifying access to both SME Growth Markets and regulated markets.	European Commission
Promote the provision of equity research on SMEs	
Address any unintended effects which MiFID II might have had on the quality and amount of equity research for SMEs.	European Commission
Improve access to equity research on SMEs by:	
• Launching a Pan-European program to cover the costs of research coverage.	European Commission
• Establishing user-friendly platforms for analysts to share their reports on.	Industry
• Amend unbundling rules to allow brokers to send SME-research reports to fund managers.	European Commission
Adapt regulation and policy measures to promote listing	
Further the Commission's proposal for a private public fund for IPOs which provides capital to companies and could support equity research, provide repayable loans and stimulate secondary market liquidity.	European Commission
Further simplify disclosure requirements for secondary public offers in the Prospectus Regulation.	European Commission
Allow market operators themselves to determine tick sizes for SME shares.	European Commission
Review the settlement arrangements for illiquid stocks under CSDR.	European Commission
Provide targeted support to smaller markets	
Provide targeted assistance and proportional requirements for smaller markets to reach their full potential.	European Commission Member States
Take measures to develop smaller markets: • Run an assessment of the impact of legislative files • Provide technical assistance to support implementation of EU laws at national level. • Propose longer time periods for transition and implementation.	European Commission
When applicable, for index purposes, consider a regional approach rather than classifying countries separately.	Industry

2. Promoting investors' participation in IPO markets

Retail investors' participation in capital markets is essential to liquidity and should be promoted. The demographic challenge we are currently facing means that every citizen needs to take an active interest in their pension plan to prepare for the future. To enable everyone to do so, government efforts in financial education are crucial as well as other efforts to create an equity culture, such as reviewing tax incentives that often benefit other types of investments over equity (please see chapter six). The non-discriminatory nature of public markets enable all investors to participate and take part in the benefits of a growing economy. As more and more investments are done privately only certain parts of the population are able to benefit from companies' growth as this segment is often closed to other types of investors.

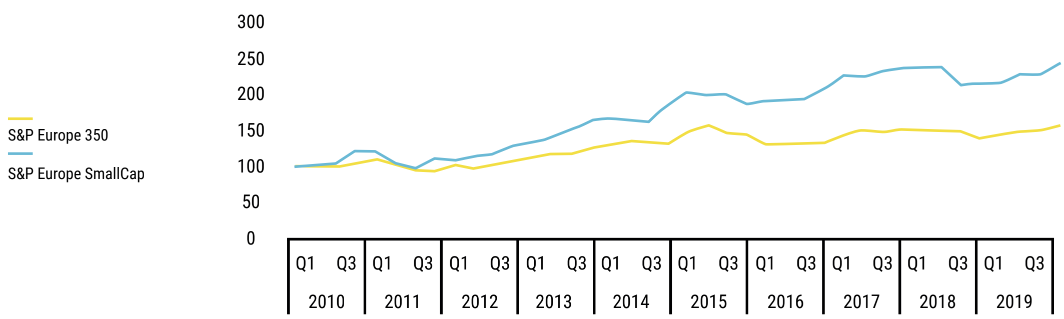
In the current low interest environment, it is crucial that individual investors can benefit from investment opportunities that provide a realistic long-term return. While there is no guarantee that an equity investment will be successful, this should be put in the context of the available alternatives. In this sense, it should be considered that compared to purchasing intermediated products (that have high fees) or saving in a normal savings account that currently offers no interest rate, it may be worth taking a calculated risk (in an overall diversified portfolio) in the expectation of getting a more interesting return. As individuals live longer and state pension systems come under pressure, it is important that citizens have investment options that enable them to finance their life beyond retirement. While some small-caps will fail, historically, returns of investing over a long-term period have overall been higher than from investing in bigger companies. Moreover, investing in bonds will not create sufficient growth to provide security for today's young people in their retirement.

The graph illustrates the aggregate developments of small caps compared to large caps over the last nine years using as a benchmark the Standard & Poor's indices.

In more general terms, MiFID II creates the impression that investing in equity is highly risky. However, better education on financial planning and investments which would allow correct understanding of risk would be more meaningful and relevant than deterring potential investors. While MiFID II has created checklists for investors before they can invest in equity, not investing in equity can be a risky choice in the current low-interest environment created by central banks. We fully support the recommendation of the Next CMU High-Level Group to introduce a definition for 'experienced High Net Worth investors' for these to have tailor-made investor protection rules. This would apply to a category of investors that have sufficient experience and financial means to understand the risk attached.[40] It is also important to set the path for how investors – even less wealthy ones – can improve their experience level because today if a retail investor is classified as not eligible to invest in equities it is very difficult to move onto the next level.

Furthermore, financial technology can be used to facilitate cross-border investments in Europe. In particular, automated financial advice could drastically cut the cost of investment advice and permit easier access to financial products. However, there are pitfalls to consider as automation could lead to investors unconsciously being led to a more risk-averse investment strategy because providers do not want to cross the regulator. Examples of this have been seen in the UK with model portfolios where all clients of a particular risk category invest in the same basket of stocks.

Development of small caps compared to large caps (2010-2019)



Source S&P

2.1 Promoting retail investors' participation in public equity markets cross-border

Markets benefit from diversity of participants that bring different perspectives and preferences. However, European end-investors are usually channelled into intermediated products that provide low yields and higher risk. As shown in the graph, compared with the US, EU households invest to a much smaller degree in shares (19%) whereas US households have 35.6% of financial assets in shares.[41]

There is therefore a need to level the playing field between packaged and non-packaged products available to retail investors and enable retail investors to participate directly in capital markets. Long-term direct investment into equity markets consistently provide higher returns than any other types of investments.

The Pan-European Personal Pension Product (PEPP) is one of many potential tools which could unlock funding and allow it to flow directly without intermediation costs from Europe's savers to Europe's businesses. In the 2015 CFA Institute survey on Capital Markets Union, 59% of the surveyed members agreed or strongly agreed that a new standardised European pension product could reinforce the single market for pensions.[42] Had the PEPP offered retail savers the option to make direct investments in shares and bonds,[43] it would have resulted in an increase in the funding options for firms, i.e. retail investors could have had the choice on what they invest in. The greater the investor´s choice, the greater the competition. Therefore, policymakers should look closer at this product again to ensure it can be used as a further choice for investors to invest pan-European.

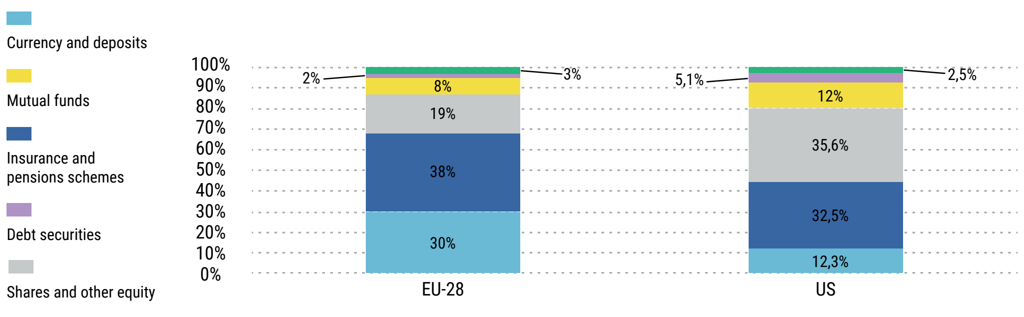
A PEPP and other more direct products designed in this way could help to achieve the key objectives of CMU through channelling retail savings into capital markets and supporting retail investors in making provisions for their own personal retirement savings. However, several obstacles hinder the creation of this form of PEPP and/or other direct products both at EU and Member State level. Currently, each Member State has divergent taxation rules, legislative barriers and legal requirements that make it unfeasible to develop cross-border savings.[44] As the taxation rules are not within the EU's authority, measures should be drafted on how to decrease the legislative and legal hindrances. Policymakers should ensure that investors have the choice of where to put their pension.

Another example of products that should be further promoted are European Long-Term Investment Funds (ELTIFs). ELTIFs aim to create long-term financing for infrastructure projects such as sustainable energy, transport, social infrastructure and can include both listed SMEs and unlisted companies' units and shares. ELTIFs thereby contribute to sustainable and inclusive growth.[45]

Some exchanges offer a subscription service to retail clients which facilitate their participation in equity markets. For instance, Deutsche Börse offers a subscription service called DirectPlace which allows retail investors to buy orders through their custodian bank already during the subscription phase.[46] There are also other FinTech companies, which focus on creating possibilities for retail investors to take part in a primary offering.

As an overarching goal, end-users should get access to direct investments and financial incentives should be promoted to enable long-term direct investment. The investment service providers – brokerage companies, private bankers, etc. - have a crucial role in promoting equity investment.

Financial assets of households in EU-28 and the US (end-2017, % of total financial assets)



Notes: The category 'Other financial assets', for the EU includes: other accounts receivable, financial derivatives, and loans. For the US it includes: other accounts receivable, and loans.

Source CEPS-ECMI

However, the investor protection regime of MiFID II creates an additional burden for service provides when trying to convince new customers (or those customers that have not invested in equities before) to invest in equities. This has led to the current situation where these intermediaries are choosing not to offer equity investments at all. These rules must be revised to reactivate the intermediaries. It should also be considered that for retail investors, fees for investment funds can act as a deterrent for investment. Supporting long-term, cost-effective investments, and specifically pension investments, is a highly effective goal because investors with a long-term outlook are crucial for well-functioning capital markets.

2.2 Improving institutional investors' ability to invest

While institutional investors have traditionally been long-term equity investors in capital markets, equity investments by insurance companies are now below the level reached before the financial crisis. European insurance companies invest less in equity compared to third country insurers and to EU pension funds. Institutional investors are often deterred from investing in SMEs due to minimum investment sizes of portfolios, the small size of available shares and documentation requirements for each single investment. Measures to facilitate institutional investment into SMEs should therefore be considered.

A review of equity capital charges under Solvency II should be a clear priority in order to remove one important bias against equity investment. Under the regime, insurers must, in most cases, hold a 39% capital charge to own shares in listed companies. In contrast, debt-related instruments are potentially less expensive since they are subject to a capital charge of 15% while Treasury bonds issued by Eurozone Member States are free of any capital charge. This also applies in cases where these instruments are held with a long-term view, with investors having significant flexibility on investments/disinvestment decisions. Policymakers should investigate and address this as today's capital requirements do not fully permit a long-term view regarding investments and, due to the low interest rate environment, insurance companies will otherwise not be able to generate the necessary returns for their policy holders.

Another important source of institutional investments is pension funds. However, the level of investments by pension funds into equity remains low compared to its potential. The share of pension capital invested in the local capital market varies greatly between countries especially where the local capital market is not very developed, pension funds may choose to invest outside the country as well as outside Europe. In some cases, there are also requirements or supervisory practices in place that prevent pension funds from investing in equity or companies listed on SME Growth Markets and even certain types of companies listed on the regulated markets. Such an example is Bulgaria where recent changes in the pension funds by-laws effectively led to all funds limiting their investments to the constituent companies of the main index only. As a result, pension capital is only very marginally used to finance local companies and secure growth for future pensioners. However, there is potential for pension funds to play a very positive role in developing the local capital market and create growth locally. A pension fund can function as an anchor investor, attracting also other investors and contributing to creating a positive upwards spiral in a less developed capital market. The opposite is also valid: the reluctance or the limited ability of pension funds to participate in IPOs deters other types of investors to put their money in the offering. Moreover, in the current context of a prolonged low interest environment and an ageing population, pension funds that are restricted from investing in equity may not be able to meet their return objectives, leading to pension cuts.

2.3 Promoting dialogue between companies and their investors

To improve IPO markets, better and more active communication between the investors and potential issuers before the IPO is required. In the past, it was common practice for the companies preparing for the IPO to meet with the potential target investors (mainly institutional investors) to get direct feedback from them on the chances of the IPO and to get a better understanding on how to communicate towards the market and what key aspects the investors take into account when making investment decisions. This practice helped companies structure the transaction and refine the investment story before officially starting the IPO process. However, the new regulatory regime of MiFID II hinders this practice by putting additional administrative burden on the institutional investors when meeting with IPO candidates. This has led to many institutional investors rejecting to meet with these companies.

Measures to make company reporting more accessible and well suited to investors' needs are crucial. This can be facilitated by creating proportionate codes designed specifically for companies such as those on SME Growth Markets and financial reporting labs to test disclosures. Initiatives on the latter include the UK Financial Reporting Lab and the EFRAG Reporting Lab. The former provides a forum for investors and companies (including smaller issuers) to exchange views on reporting and investors to provide input on information and formatting used by companies.[47] The EFRAG European Corporate Reporting Lab, set up in 2018, is intended to serve a similar role to identify and share best practices in corporate reporting. Its first project will be on climate-related reporting.[48]

In 2015, the European IPO Task Force recommended that companies should be given the right to identify their shareholders through a European identification system. This has partly been addressed in the recent review of the Shareholder Rights' Directive (SRD II) which is very welcome. As shown by a study performed by EY, while in many countries companies had a right to identify their shareholders, this right was limited in practice by either putting minimum thresholds for the size of the shareholders' holdings or by allowing shareholders to choose not to be identified by the company.[55] SRD II sets minimum harmonised thresholds that should help improve communications between issuers and shareholders, as a prerequisite for such information is that issuers know who their shareholders are. As pointed out by EY, digital solutions could also facilitate such communication, particularly in a cross-border context.[49] Monitoring of the implementation of SRD II is now necessary to ensure that the intentions of the co-legislator are respected. Moreover, specific barriers between issuers and the legal owners of shares should be removed. The various rules and regulation regarding 'acting in concert'[C] should include an overall exemption if legal owners of shares - separately or collectively - are engaging with European companies during the IPO process and listing, for the latter unless the engagement aims at any board appointment and/or dismissal and change-of-control situations. Another area of communication that deserves attention is that between institutional investors and issuers. This is commonly covered under stewardship principles. According to the Financial Reporting Council, 'stewardship' "is the responsible allocation and management of capital across the institutional investment community to create sustainable value for beneficiaries, the economy and society". This includes monitoring assets and service providers, engaging issuers and holding them to account on material issues, and publicly reporting on the outcomes of these activities.[50]

The Financial Reporting Council has to this effect recently adopted a new version of the UK Stewardship Code which was published on October 2019.[51] A stewardship code is also currently being developed in Germany and there are existing ones in e.g. Denmark, Italy and the Netherlands.[52] The revised EU Shareholder Rights Directive contains a specific article on 'engagement policy' (article 3g). This article to some extent codifies principles of existing national stewardship codes at EU level. At the same time, the market soundings regime under MAR makes it procedurally more difficult to talk to shareholders to gain backing for an anticipated corporate action.

Digital solutions can help improve communication between companies and investors. For instance, most information currently provided to professional investors could be made available live or using digital platforms. As shown by EY, the information currently provided in prospectuses could be streamlined and made more user friendly e.g. through the use of video rather than text.

To encourage more shareholders to participate in AGMs and have an ongoing dialogue between shareholders and the listed company, regulation should support the company in organising and conducting a hybrid annual general meeting of shareholder. During the AGM which will actually take place in person, the company will simultaneously use digital tools to broadcast and connect online attendees, giving all shareholders the opportunity to speak and cast votes - both online and in person at the meeting. Making use of digital solutions could help increase participation, reduce costs and environmental impact (due to less travel and fewer printed materials).

We endorse the recommendation of the Next CMU High-Level Group to accelerate the European Electronic Access Point project under the Transparency Directive to promote access to company reporting across the EU.[53]

[C] For further details please see, ESMA, 2019 Public statement, 'Information on shareholder cooperation and acting in concert under the Takeover Bids Directive'.

Recap of recommendations

2. Promoting investors' participation in IPO markets

Recommendations	Key stakeholders
Channel retail savings into capital markets and equity investments and support retail investors in making provisions for their retirement savings.	European Commission Member States Industry
Reconsider requirements and supervisory practices that prevent pension funds from investing in equity or companies listed on SME Growth Markets	European Commission Supervisory Authorities
Introduce a definition for 'experienced and knowledgeable High Net Worth investors' for these to have tailor-made investor protection rules.	European Commission
Lower equity capital charges under Solvency II to remove one important bias against equity investment and ensure institutional investors can invest in equity.	European Commission
Encourage better dialogue between European companies and their investors during the IPO process and listing. Using digital means to this effect should be encouraged.	Industry
Amend regulation to support companies in organising and conducting hybrid annual general meetings of shareholders.	European Commission, industry
Monitor the implementation of SRD II to ensure that the intentions of the co-legislator are respected.	European Commission
Remove barriers between issuers and the legal owners of shares. Include an overall exemption in rules and regulation regarding 'acting in concert' if legal owners of shares are engaging with European companies during the IPO process and listing.	European Commission
Accelerate the European Electronic Access Point project under the Transparency Directive to promote access to company reporting across the EU.	European Commission

3. Creating a European equity culture

The lack of an equity culture is a major barrier to developing the SME IPO market as company founder-owners are often not ready to open the ownership structure of their company and let financial investors in (regardless of whether it is a private equity or public equity investor). This problem is even more extensive in the CEE region where the vast majority of smaller companies are still in the hands of first-generation entrepreneurs (for example in Hungary it is 75% while in more established economies it is around 30%). This could potentially bring a wave of corporate succession as many companies could be offered for sale. On the one hand, this means a significant challenge to these economies, but on the other a unique opportunity to improve the equity culture and to bring these companies closer to the capital market. In order to exploit this opportunity, support-measures need to be offered that make capital markets more accessible for these companies. More advisers that help SMEs access markets would be very helpful in this regard.

3.1 Promoting companies' financial education as users of capital markets

Exchanges run a number of educational initiatives and are constantly working to raise awareness among companies about the benefits of listing. At an early stage of companies' lives exchanges also play an increasingly important role in supporting the ecosystems in the run up for IPO preparation. FESE Members support companies looking to raise capital in the pre-IPO stage through their own programmes: Athens Stock Exchange 'Roots'; BME 'Pre-Market Environment'; Börse Stuttgart 'Nordic Pre Market' (for the Nordics) and 'Startbase' (for Germany); Deutsche Börse 'Venture Network'; Euronext 'FamilyShare', '#IPO Ready' and 'TechShare', and Nasdaq Stockholm 'EIC Investor Day @ NASDAQ'. London Stock Exchange and Borsa Italiana also run the ELITE programme. Companies taking part in these programmes are future IPO candidates and are typically dependent on funding for further growth.

These programmes:

- *Connect SMEs to investors and help them gain access to professional services;*
- *Provide stakeholder coordination and management;*
- *Provide due diligence and prospectus writing, investment case development;*
- *Provide IPO roadshow support and financial public relations and marketing services;*

They are often targeted to different types of companies, focussing on their specific situation and needs.

There are also issuer membership organisations such as AEM, Middlenext, SEG and The Quoted Companies Alliance that support pre-IPO and listed issuers and provide many investor events, guides and briefings on how to make the best use of the public markets. These initiatives are usually not for profit organisation and are funded by the issuers themselves

Any support regulators would be able to offer in respect of awareness raising would be most helpful. For instance, it has been suggested that ESMA could set up a central information portal for companies which would provide information on the different mechanisms for raising capital cross-border.

Further recognition through EU-wide initiatives, for example in the context of the upcoming InvestEU framework, which would support exchanges in their information activities, is welcome. This support could intervene at different levels of financial education: educating large companies about transparency and corporate governance on the one hand, while focusing on alternative sources of funding by listing on SME Growth Markets for smaller companies on the other. This would be especially beneficial to smaller markets, which do not have the resources to run such large-scale educational initiatives on a continuous basis.

Post-IPO education initiatives covering specific aspects of the life as a listed company are also needed. One such example is ensuring that only high-quality non-financial information is provided to investors. This tends to be a significant issue for the less developed CEE region where the relatively inexperienced SMEs produce irrelevant non-financial reporting. One part of the problem might be attributed to the mindset of the management not being focused on ESG principles. However, the rest is due to a lack of understanding of how a comprehensive non-financial information report should be structured. There is sufficient evidence that larger non-listed companies produce better quality reporting than smaller listed businesses. With the investors' focus shifting towards ESG-conscious companies, there is a huge risk than many companies will not be properly assessed as a result of their inadequate disclosure. That will ultimately translate into less investments being made into them and might foster a divergence of the CEE region from the rest of the EU.

However, while educational initiatives are important, ultimately, companies will decide what type of funding to seek based on cost-benefit analyses and if the costs are perceived as too high (possibly as an effect of an unlevel playing field), they will opt for other types of financing when this is readily available (please see chapters one and four).

3.2 Promoting investors' financial education

Studies show that people that are more financially literate make better decisions in relation to their finances, invest in more diverse products and are more likely to plan for their pensions.[54] Citizens who lack basic financial concepts are not well equipped to make informed financial choices regarding saving, investing, and borrowing.[55] In fact, less than half of European households (43%) invest in any type of financial product with the notable exception of Sweden–where more than 60% of households invest.[56]

EU citizens include some of the "world's best performers (Sweden, Denmark) as well as those that score below global average (Romania, Portugal) in financial literacy rankings". In addition, there are striking differences between men and women, young and old people and educated and less educated people. [57] The gender gap in financial literacy has been well documented as women overall score lower on tests of financial literacy and are also more likely than men to answer that they do not know the answer to a question.[58] In a context where citizens will be required to make more investment decisions for themselves to prepare for their old age, financial illiteracy becomes an even more important issue as it could reinforce inequalities.

The Directive on credit agreements for consumers relating to residential immovable property includes an article that indicates that member states "shall promote measures that support the education of consumers in relation to responsible borrowing and debt management, in particular in relation to mortgage credit agreements" and the European Commission is tasked with publishing "an assessment of the financial education available to consumers in the Member States and identify examples of best practices which could be further developed in order to increase the financial awareness of consumers".[59] This is a very welcome inclusion that could potentially be reproduced in other areas of financial markets education.

Besides consumer education, focus must be put on improving the financial literacy education in primary and secondary schools as it is proven that younger generations are much more open to this practical knowledge than adults. Some countries have already taken steps in this direction; to strengthen this, an EU wide programme should be launched to promote and support the inclusion of financial education in the national curricula of Member States. Regulatory authorities should work closely with schools and universities to this end. To finance such an initiative, any state backed fund investing in small-caps should use part of the return to invest in this education. Moreover, every university and higher education course should have a compulsory module covering markets and access to finance, considering that professionals in every field benefit from a good understanding of these topics.

Recap of recommendations

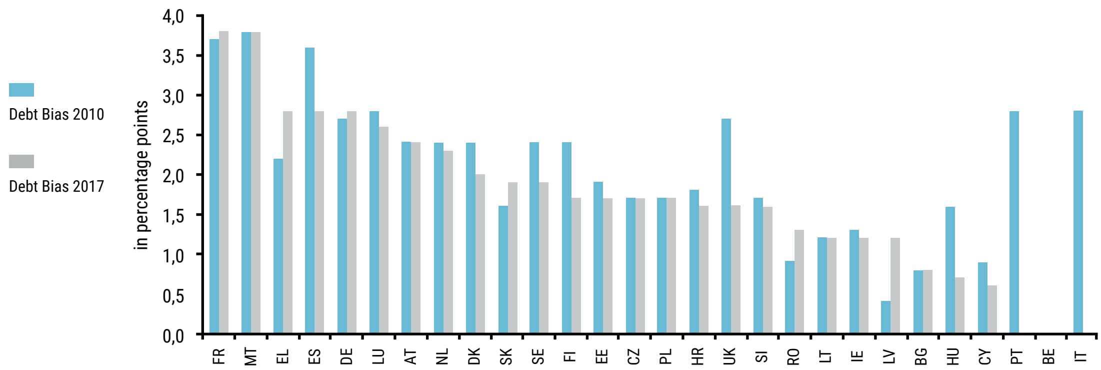
3. Creating a European equity culture

Recommendations	Key stakeholders
Launch public campaigns to support companies' financial education about capital market financing and investment.	Industry, Member States, European Commission, ESMA
Promote financial literacy of investors through educational programmes included in national curricula.	Member States
Promote education of financial advisers.	Industry

4. Improving tax incentives for investment in IPOs and equity overall

From a company/issuer perspective, equity is more heavily taxed than debt in most countries, which creates a disincentive for equity investment (the graph below shows the evolution and the persistence of the debt bias in the EU over the past years). Interest payments on debt may, subject to certain restrictions that may exist in certain countries, generally be deducted from profits before they are taxed, whereas equity financing does not receive any form of tax relief (and indeed may be subject to significant taxation both in terms of capital gains and dividend payments). This structural bias towards debt financing encourages companies to take on debt rather than equity; yet high debt-to-equity ratios increase the likelihood of bankruptcy (in that companies are obligated to pay back interest and principal on a debt) and encourages risk-taking, often at the expense of creditors rather than shareholders,[60] and as we have seen, in some instances, of taxpayers too. Only equity can supply a reliable risk buffer against external shocks.

Debt bias in the EU



Source: ZEW (2017)

Rebalancing the current bias towards debt financing by alleviating the burdens on equity finance to create a level playing field should be at the core of CMU for two reasons. Firstly, it should encourage companies to strengthen their equity base and discourage levels of leverage that are too high, thereby improving their financial stability via increased loss absorption capacity. Secondly, it should result in investors paying lower taxes on their equity investments, incentivising provision of equity capital as an alternative source of funding. It is not only important to rebalance this bias, but also to harmonise tax procedures.

We encourage EU policymakers to consider the different characteristics of equity and debt markets when undertaking capital markets regulatory initiatives. Some of the fiscal arrangements currently in place act as a barrier towards the development of public capital markets in the EU. A review of these arrangements should not result in the creation of a new fiscal imposition on debt financing, but rather remove and alleviate the burdens on equity financing to create a level playing field.

Annual studies and surveys by the European Commission on tax policies in the EU[61] should conduct more in-depth impact assessments on the cost of capital arising from the current tax bias against equity investments. Currently, in many European countries we either observe a lack of positive tax incentives, or the presence of significant disincentives, whereby the tax system is more favourable to debt than to equity issuance. To orient more investor/investment flows into listed equity, bond and derivatives instruments, new or existing tax and regulatory disincentives that suppress investor demand should be avoided. Such changes would have a positive impact on the overall attractiveness of European public capital markets. While proposals have been made under the CMU to address the tax-bias against equity financing in favour of debt-based models, it is imperative that this work be completed under the next mandate.

4.1 Reducing tax costs at the IPO stage for employees, management and owners

To encourage early stage individual entrepreneurial behaviour that may involve risk, we recommend that tax costs that may crystallise at the IPO stage are reduced or eliminated. Examples of such tax costs may include capital gains on the selling of founder shares and income tax on the vesting of share options. Such tax breaks could be targeted to specific sectors of the economy e.g. high tech; companies based in enterprise zones etc and therefore be tied to wider strategic objectives. The tax breaks could come in the form of preferential rates of tax; exemption from tax or the ability to roll-over/defer such tax against future investment in certain unquoted entities.

4.2 Ending tax discrimination of equity towards debt and other forms of investments

The debt-equity bias on taxation should be addressed with careful support for an allowance for corporate equity. However, the introduction of such a measure by Member States has not been universally successful in stimulating equity investment and have sometimes been used for tax avoidance purposes. Consequently, any such measures would need to be carefully considered within national and international tax frameworks to both ensure that their aims are achieved in a cost-effective manner and that they do not become vehicles for tax avoidance. If necessary, the debt-equity bias question should be detached from the current C(C)CTB proposals which remain blocked in the Council

The European Commission should create a robust EU framework for withholding taxes beyond the current Code of Conduct.[62] The complex and inefficient processes that prevent an otherwise eligible beneficial owner from claiming entitlement to a reduced rate of withholding tax has been estimated at around EUR 8.6 billion within the European Union alone. Therefore and as set out in the Report of the Tax Barriers Business Advisory Group ('T-BAG Report') and as provided for under the OECD's Treaty Relief and Compliance Enhancement Implementation Package ('TRACE'), there should be a simplified process by which such beneficial owners could claim entitlement to the lower rate of withholding tax through an authorised intermediary system. This would allow eligible financial intermediaries to make bulk claims for relief at source or for refunds of withholding tax on behalf of the beneficial owner they represent.[63] The beneficial owner would be required to provide the authorised intermediary with a self-declaration asserting entitlement to the lower rate of withholding tax. The tax authorities would receive annual reporting from the authorised intermediary together with the ability to audit the authorised intermediary and therefore check compliance. This system would simplify the claim process, reduce unnecessary tax leakage and therefore enhance returns to investors. This report welcomes the news that Finland has adopted the TRACE system and that this system will be operational from 1st January 2020.

4.3 Providing tax incentives to encourage long term investment in small and mid-cap quoted companies

A survey by CFA Institute conducted in 2015 showed that respondents considered that the biggest barriers to the development of European Union Capital Markets are differences in taxation treatment across jurisdictions and differences in legal frameworks surrounding the ownership and transfer of securities.[64] Further cross-border investment should be facilitated as some member states currently have excess liquidity and others suffer from a lack of liquidity.

The European Commission should conduct a study on tax incentives for SMEs, specifically when they are seeking debt or equity financing. This study should include an overview of existing incentive practices across the EU, assessment of the impacts of the various national regimes, as well as the identification of best practices that could be proposed as recommendations on a pan-European level.

Overall, more means to encourage small investors to invest in equity in various ways such as directly, via funds, via pension plans etc should be adopted. Such encouragement could come in the form of tax exemptions on gains or income received or tax deferrals such that any tax due would be deferred until the capital or income is drawn down. This would possibly encourage investment in growth companies and thus create a more liquid market. Specifically, tax advantages could be targeted against investments made into new issuances; companies with gross asserts below a certain level etc. Furthermore, recognising that retail investors may have insufficient knowledge or access to information to make relevant direct investments, such tax advantages could be given to certain collective investment schemes investing in permissible assets. This would allow retail investors to benefit from fund management expertise as well as spreading the risk through investing in a diversified portfolio of eligible assets.

Sweden is a successful example where a special tax treatment of savings in funds and equities has promoted investments. In 2012, a special treatment for Investment Savings Account (ISK) was introduced, where instead of paying capital gains tax, the saver pays an annual standard rate of tax.[65] According to the Nordic Securities Association there are 3.3 million Investment Savings Accounts in Sweden. These accounts allow retail investors to be active on their account without having to report every transaction, gain or loss to the tax authorities. Similar concepts have been implemented in some other Members States and some are under way. For example, in Hungary, there is a special 'Long-term Investment Account' where no income is taxed (no capital gain tax, no interest income tax and no dividend tax) in case the money is not withdrawn from the account within five years. The European Commission can continue to play an important role in sharing best practices among Member States in order to support these types of measures.

The frameworks for employee share option programs should be simplified. This would facilitate for small companies key staff and allow employees to share the growth journey of the company that employs them. Employee share programs also contribute to financial education and developing an equity culture. An example is provided by an open letter from the founders of music streaming app Spotify to Swedish politicians sent in 2016, where they stated that in order to be competitive as an attractive company for international talent they need to offer employee share option programs, something they considered impossible under Swedish tax law and therefore called for a review.[66] Employee share options should be taxed when exercised, not when granted.

Recognising that SME growth companies may represent a higher level of risk, tax incentives could also be given to allow the investment in such a company – either directly or indirectly – to be deducted for tax. Such a deduction could be limited to an annual monetary amount and again subject to certain restrictions on qualifying investments, holding period etc.

A pan-European credit referral and mediation scheme for when an SME's bank loan request has been rejected should be set up. The scheme would identify possible alternative finance sources suiting the company's profile, from capital markets to venture capital and crowdfunding.

State aid measures should be assessed as this may help to achieve more cross-border savings if incentives were harmonised. Establishing an EU tax free (for retail investors) investment fund that invests solely in small-caps should also be considered.

Any new tax policies (including proposals such as the Financial Transaction Tax (FTT)) which would discourage investors from investing in capital markets, in particular, in listed instruments, should be avoided. We urge policymakers to fully consider the implication of new tax policies that could be detrimental to EU financial markets and their users, increase distortion on the market and potentially weaken EU competitiveness. Defining the right regulatory and tax environment is key to creating a bigger "demand" side for capital markets and enhancing Europe's global positioning. In the absence of global or even EU-wide cooperation, it is important to carefully assess the consequences of further taxation of financial activities. Many of the transactions subject to a tax would relocate to non-cooperating countries, thereby reducing revenue prospects, impacting the effectiveness of supervision and increasing fragmentation. We note that discussions are underway between certain Member States to reconsider the European Commission's FTT proposals. Whilst we do not support such a tax as it will discourage investors from investing into capital markets, we strongly recommend that any implemented proposals provide that new share issuance on every public market is exempt from such a tax; and that all trading on SME Growth markets is exempt from such a tax (as is the case for the London AIM market). We believe that this would be consistent with the intent of the FTT.

Recap of recommendations

4. Improving tax incentives for investment in IPOs and equity

Recommendations	Key stakeholders
End tax discrimination of equity compared to debt and adopt measures to instead favour equity investments.	Member States
Review fiscal incentives and reduce or eliminate tax costs that may occur at the IPO stage for employees, management and owners.	Member States
Provide tax incentives to encourage investment in SME growth companies and simplify the frameworks for employee share options.	Member States
Share best practices among Member States to promote equity investments.	European Commission
Create a robust EU framework for withholding taxes.	European Commission
Conduct a study on tax incentives for SMEs, specifically when they are seeking debt or equity financing.	European Commission
Set up a pan-European credit referral and mediation scheme for when an SME's bank loan request has been rejected.	European Commission
Assess state aid measures, as this may help to achieve more cross-border savings if incentives were harmonised.	European Commission
Avoid adopting tax policies which would discourage investors from investing in capital markets, such as the Financial Transaction Tax,	European Commission, Member States

5. Building a regulatory framework that favours technological innovation and can handle potential regulatory adjustments

Technology has always been a source of structural change and disruption. For financial markets, precedents include the rise of electronic trading and algorithmic trading. FinTech and RegTech have the potential to support the market to overcome certain barriers, while delivering efficiency gains and supporting risk mitigation. However, they could create ramifications throughout the whole lifecycle of securities on capital markets. FinTech can help expand access to financial services for consumers, investors and companies, bringing greater choice and more user-friendly services, often at lower prices. New financial technologies can help individuals as well as SMEs, including start-up and scale-up companies, to access alternative funding sources to support their cash flow and risk capital needs. The development of FinTech will bring about fundamental changes to the ways in which the financial sector and the financing of the economy function. It has the potential of reducing costs, boosting the speed of services and drastically increasing choices for fund-seeking companies, institutional and retail investors, as well as consumers of financial services.[67]

5.1 Safeguarding a level playing field for activities in the field of new technologies by applying the principle "same business, same rules"

European financial services regulation should cover new technology and regulators should ensure that it is applied carefully and allows for efficiency gains. The principle of "same business, same rules" must be the driving force, since this is crucial to ensure a level playing field. To protect investors, policymakers should allow for a sandbox approach in the EU to make sure the consequences of new technologies are well understood before they compete openly.

As noted by the European Commission, crowdfunding "is increasingly establishing itself as an important part of the funding escalator for start-ups and early stage companies" as an alternative to bank funding.[68] This is a welcome development as companies need access to different types of funding at different stages of their development; e.g. crowdfunding, business angels, venture capital, private placement, IPOs on Growth & Main Markets as well as secondary capital raisings.

Crowdfunding can be a positive element for enterprise funding in general and for reviving public corporate financing, especially since it can help:

- *Grow the pipeline of companies preparing for an IPO;*
- *Build a stronger equity culture in Europe, which would eventually have a positive impact on the participation of retail investors in public equity markets, which is positively correlated with better access of SMEs to IPOs; and,*
- *Revive the local ecosystems necessary for IPOs of smaller companies.*

Notwithstanding these benefits, crowdfunding is not a substitute for IPOs. Public markets offer easy access to companies wanting to raise capital and to all investors, retail and institutional, wishing to diversify their portfolios. However, in terms of scale, even if crowdfunding continues to grow at a very high speed, the amount of funds that can be raised individually and collectively through crowdfunding cannot be expected to meet the financing gap faced by European enterprises over the coming decades. The capital pooled by crowdfunding platforms remains limited when compared to the capital raised on public markets. In particular, companies that have the biggest impact on job growth are those at the high end of the funding escalator scale, which means that, even if crowdfunding growth trends continue, they may have only a modest impact on new jobs created in Europe.

However, during the negotiations of the crowdfunding proposal policymakers have agreed to raise the threshold for when a prospectus would need to be produced beyond EUR 1 million in capital raising up to EUR 5 million. This risks creating issues in terms of investor protection as well as level playing field for exchanges that apply a full range of EU trading rules to ensure market integrity and consumer protection. The implications of this measure will now need to be carefully assessed.

In recent years, initial coin offerings (ICOs) have also become increasingly common. They have been lauded for their simplicity compared to IPOs and described as offering "hassle-free and very fast ways to raise huge amounts of money", as well as allowing bypassing venture-capital, giving investors easy exit options and offering faster preparation and lower costs compared to IPOs.[69] However, ESMA has raised concerns regarding investor protection (specifically whether investors are aware of the level of risk involved) and firms conducting business without applying EU legislation.[70] In an own initiative report, the ESMA SMSG underlines the importance of legal certainty in ICOs and crypto-assets. The report points to the need for clarification regarding the application of existing financial regulation to virtual assets.[71] Such clarification is necessary given the very divergent national regulatory approaches to crypto-assets. This creates an unlevel playing field within the EU and it is therefore welcome that the European Commission is considering potential regulatory measures to address crypto-assets currently not covered by EU legislation.[72] However, while it is very welcome that ESMA and the European Commission are investigating these developments, market participants have sometimes experienced that regulators move too late in relation to new developments. For example, in the Croatian market, significant investments into crypto-assets recently took place, while at the same time no companies came to the primary market. The unlevel playing field that can emerge would need to be addressed more rapidly in these instances, as crypto-assets in this case benefitted from the lack of regulatory requirements, including in terms of investor protection. France has been one of the first countries to introduce a legislation for ICOs. The loi Pacte includes a specific framework for issuers of tokens and service providers in digital assets, while a new legislation covers the blockchain technology when used to issue and register non-listed securities. Through such legislations, French policymakers aim to make capital markets more efficient by supporting the use of technology. However, adequate investor protection must be guaranteed through highly standardised disclosure requirements.[73] Combining innovative technologies, for instance blockchain based technologies, with established, highly regulated market infrastructures would be the natural choice in order to ensure market stability while making use of the innovative potential brought about through FinTech.

There are some interesting tech innovations in the small-cap market that enable retail investors to be involved in money raising in the same way as institutional investors and to be involved in the same presentations/briefings as those received by institutional investors and have more access to companies.

As highlighted in chapter two, some exchanges now offer subscription services to retail clients which facilitate their participation in equity markets. For companies, benefits can for instance include use cases for regular prospectus updates. Technological developments can also enable hybrid annual general meetings (AGMs) (as further discussed in chapter two). Such technology facilitate shareholder engagement and increase liquidity as it includes retail investors. However, doing virtual-only AGMs, as is common in the US, presents concerns as it can be used to restrict shareholders' ability to hold company boards to account.

It is important to establish key principles upon which the EU can build a role in facilitating the development and implementation of FinTech. These principles include the need for:

- *The application of the same rules for the same services and risks (including across different pieces of legislation) based on the principle of technology neutrality;*
- *A risk-based approach built on proportionality and materiality which allows for flexibility, particularly in respect of innovation with small groups of customers (i.e. sandboxes), while ensuring a level playing field across the EU;*
- *A balancing of the local (country) risks alongside the benefits of cross-border markets (i.e. scalability, interoperability and passporting of services).*

Recap of recommendations

5. Building a regulatory framework that favours technological innovation and can handle potential regulatory adjustments

Recommendations	Key stakeholders
Safeguard the level playing field between capital raising activities through new technologies by applying the principle "same business, same rules"	European Commission
Clarify the application of existing financial regulation to virtual assets.	European Commission

6. Capital markets' vital importance in supporting the transition to a sustainable economy

Fighting climate change is a top concern of EU citizens. 93% consider climate change a serious problem and 79% see it as a very serious problem.[74] We welcome and support the commitment by EU policymakers to find collective solutions to the global issue of climate change— specifically with the High-Level Expert Group on Sustainable Finance and the Action Plan on Financing Sustainable Growth. It is clear that in financing a future sustainable economy, capital markets have a crucial role to play.

Market developments reflect an enormous appetite by institutional investors and in particular EU based ones to contribute to the success of the Paris Agreement and the UN Sustainable Development Goals (SDGs). Green and other types of sustainable bonds have recently experienced massive success, as demonstrated by issuance. Shareholders increasingly prefer to invest in companies that demonstrate beneficial social and/or environmental impact alongside a solid financial return. In recent years, a substantial increase in ESG/sustainable investments by institutional investors has taken place. [75]

Globally, sustainable investing assets in the five major markets stood at USD 30.7 trillion at the start of 2018, a 34 % increase in two years. In all regions, except Europe, the market share has also grown. In Europe total assets committed to sustainable and responsible investment strategies grew by 11% from 2016 to 2018 to reach EUR 12.3 trillion (USD 14.1 trillion), but their share of the overall market declined from 53% to 49% of total professionally managed assets. It is suggested that the latter may be due to the introduction of stricter standards and definitions. Strategies for sustainable investing include exclusionary screens, ESG integration, positive impact investing, and corporate engagement and shareholder action.[76]

Likewise, policy developments at the European level underline the importance of creating sustainable financial markets and financing sustainable growth. In 2018, the European Commission published an Action Plan on sustainable finance that outlined legislative and non-legislative actions, most of which have now been taken. This was followed by a series of legislative proposals, to:

- *Create a taxonomy;*
- *Ensure that institutional investors disclose to what extent environmental, social and governance (ESG) factors are considered;*
- *Create new definitions for environmentally sustainable benchmarks; and*
- *Ensure that clients' sustainability preferences are taken into account.*

These files have now concluded at political level. In parallel to the legislative work, the European Commission has also established expert groups to advise on the technical aspects of the taxonomy, green bond standards, benchmarks and disclosures.

A working paper published by the ECB in 2019 shows that for given levels of economic and financial development and environmental regulation, CO2 emissions per capita are lower in economies that are relatively more equity-funded. This is due to the role stock markets play in reallocating investment towards less polluting sectors and push carbon-intensive sectors to develop and implement greener technologies.[78] In a follow up article, the authors provide evidence that increasing the equity financing share to one-half globally would reduce aggregate per capita carbon emissions by about one-quarter of the Paris Agreement commitment and call for supporting equity-based initiatives rather than policies aimed at decarbonising the European economy through the banking sector.[79] Promoting CMU and sustainable finance are therefore mutually reinforcing projects which should be pursued jointly but with due regard to the resources available to companies listed on public markets.

Furthermore, it is important to always keep in mind that financial markets reflect developments in other parts of the economy. As such, the sustainable finance agenda cannot, by itself, realise the goals of the Paris Agreement. Regulatory changes should not lead to unintended consequences in terms of risk management and it should be kept in mind that labels and standards which do not reflect market fundamentals can distort economic incentives and lead to a build-up of bubbles in the economy. Ultimately, a shift in all economic agents' mind-set is the most crucial component of a successful transition to a low-carbon and resource-efficient economy that is geared towards inclusive growth and awareness of long-term risks. The increasing market demand for sustainable products point to such a change as there is, on the one hand, investors looking to invest in innovative companies proposing sustainable solutions to the issues at hand and, on the other, investors looking to limit their exposure in assets that carry climate related risk. As such, company management also needs to consider how to incorporate ESG consideration in their strategy and improve their reporting in these areas.[80]

6.1 Adopting measures that mobilise sustainable finance in Europe

A transparent and consistent approach, in line with ESG aspects, by the real economy, financial industry and regulators holds great opportunities for international capital markets, both in the area of risk assessment and for the identification of new business areas. Such an effective focus on sustainable finance requires a long-term vision that is proportional to company size and ensures a level playing field between public and private markets. The alignment of different pieces of legislation, e.g. reporting requirements with the taxonomy provisions and other regulations, is a prerequisite. A clearly defined taxonomy, whereby agreement on what constitutes environmentally sustainable assets is found, is a necessary starting point for other actions, such as standards and labels. This will also assist high quality and comparable financial disclosures. We would also like to stress the importance of addressing social aspects within the sustainable finance agenda. Climate-related matters should not be treated in isolation as this could have a negative impact elsewhere; these matters should rather be linked to wider sustainability risks.

The needs of investors and other stakeholders for non-financial reporting have increased dramatically over the last decade. However, companies struggle to provide consistent, comparable and reliable non-financial reporting as there are too many frameworks and none of them covers all aspects. As environmental, social and governance (ESG) is becoming increasingly important for investors it is likely that the cost of capital will increase for companies that are omitting or providing poor information around this topic. This may not be a significant point with current level of quantitative easing but in the medium to long-term, this could become a significant issue. Alignment and uniformity of standards/frameworks is therefore necessary. The European Commission has recently adopted non-binding guidelines for climate-related reporting. The existing non-binding guidelines and its update are useful towards improving climate-related reporting. However, the current scope of the Non-Financial Reporting Directive (NFRD) is too restrictive as it excludes some very large publicly not listed companies. For these large private enterprises, non-financial reporting may be more relevant than for some of the companies within the current scope.

As part of the European Commission's Action Plan on Sustainable Finance, the European Supervisory Authorities were asked to gather evidence and advice on undue short-termism in financial markets as the European Commission considers that decisions taken by corporations do not fully reflect long-term aspects that would be required to put the EU economy on a sustainable path and manage the transition towards a low carbon economy. Short-termism was defined as the focus on short time horizons by both corporate managers and financial markets, prioritising near-term shareholder interests over long-term growth of the firm.[81] ESMA delivered its advice in this area in December 2019.[82] Debate over the reduction of periodic reporting requirements has been ongoing for a long time with the argument often being made that private companies can focus on the long-term strategic interests of the company, while management of public companies worry about meeting investor expectations from quarter to quarter. However, reducing the frequency of financial reporting would decrease the level of transparency and investor protection, and would have a material impact on long-term investment by companies. Reducing reporting frequency would further increase the cost of capital. A good approach for dissuading short-termism would be to focus on companies' incentive structures. To encourage a longer-term view, companies should extend their performance periods in their incentive plans from three years to five years.[83]

IPO markets for small companies should establish the right balance between incorporating ESG considerations whilst still creating an inviting and value creating environment for innovation and entrepreneurship. Intelligent application of reporting requirements, financial and non-financial, should be undertaken. This should avoid a disproportionate burden on small companies, which would make the IPO market unattractive, particularly if such reporting requirements are not applied to private companies.

Recap of recommendations

6. Capital markets' viral importance in supporting the transition to a sustainabe economy

Recommendations	Key stakeholders
Develop a long-term and mutually reinforcing CMU and sustainable finance vision, which is proportional to company size, and ensures a level playing field between public and private markets.	European Commission
Incentivise market agents towards longer-term orientation by: • Ensuring non-financial reporting requirements are proportionate especially for small growth companies • Reassessing the range of factors needed to incentivise market participants in evaluating longer-term risks. • Consistent, comparable and material reporting on non-financial information by issuers.	European Commission
Ensure alignment of different pieces of legislation, e.g. reporting requirements with the taxonomy provisions and other regulations.	European Commission

7. About the European IPO Task Force

The European IPO Task Force was created in 2014 to raise awareness of key obstacles to efficient IPO markets and provide recommendations on areas requiring action. It was coordinated by FESE, together with EuropeanIssuers and Invest Europe, and founded on the belief that European equity capital markets, for which the IPO process is the entry point, play a crucial role in the economy. The work of the European IPO Task Force resulted in a report published in 2015, available on the FESE website.

In 2019, Accountancy Europe, CFA Institute, EBRD and FESE took the lead in relaunching the European IPO Task Force. It was relaunched to assess recent developments in IPO markets and take stock on the outcomes of the recommendations provided by the original European IPO Task Force in 2015. In addition, the Task Force has assessed developments related to sustainable finance, new technologies and developments in CEE markets.

The European IPO Task Force is composed of corporate representatives and independent experts from major segments of the financial sector involved in the admission of companies to listing. Its participants are united in the belief that European public equity markets need to provide better opportunities for companies to finance themselves and that addressing the systematic decline of IPOs in Europe is necessary to further the long-term sustainable development Europe needs. The Task Force aims to deepen the understanding of the longstanding trend of decreasing numbers of new listings and listed companies on public markets.

Role of participants and observers

The views expressed by participants, at meetings and in their support for this report, are views of the individuals and should not be seen as representing the official views of the organisations for which they work. The recommendations in the report represent a compromise between different market participants. Representatives from European institutions were observers in the European IPO Task Force. As this report makes recommendations to policymakers, their participation in the Task Force should not be considered as an endorsement of the report's findings and recommendations. This equally applies to the Task Force's industry observers.

European IPO Task Force

CHAIR

Caroline Nagtegaal
European Parliament (Chair)

PARTICIPANTS

Rients Abma
Eumedion

Günther Artner
Erste Group

Sebastien Boulet
Amundi

Ivana Gažić
Zagreb Stock Exchange

Piet Hemschoote
Accountancy Europe

Josina Kamerling
CFA Institute

Nick Kaufmann
Wood & Company

Adam Kostyal
Nasdaq

Camille Leca
Euronext

Niels Lemmers
European Investors/VEB

Aleksandra Mączyńska
Better Finance

Daniela Peterhoff
Oliver Wyman

Paul Radcliffe
EY

Rainer Riess
FESE

Alexander Schindler
Union Asset Management

Abel Sequeira Ferreira
AEM

Hauke Stars
Deutsche Börse Group

Hannes Takacs
EBRD

Ivan Takev
Alaric Securities

Juan Carlos Ureta
Renta 4

Tim Ward
Quoted Companies Alliance

PUBLIC INSTITUTION OBSERVERS

Angelos Delivorias
European Parliamentary Research Service

Mats Isaksson
OECD

Paula Kirppu
Ministry of Finance, FI (EU Presidency)

Tatyana Panova
European Commission (DG FISMA)

Joachim Schwerin
European Commission (DG GROW)

Stefano Spinaci
European Parliamentary Research Service

Lúcio Vinhas de Souza
European Commission (EPSC)

INDUSTRY OBSERVERS

Florence Bindelle
EuropeanIssuers

Javier Mata
Banco Santander

Christophe Verboomen
Invest Europe

ORGANISERS

Sandra Andersson
FESE

Johan Barros
Accountancy Europe

Roberto Silvestri
CFA Institute

Attila Tóth
EBRD

About the co-organisers

ACCOUNTANCY EUROPE

Accountancy Europe unites 51 professional organisations from 35 countries that represent 1 million qualified accountants, auditors and advisors. Qualified accountants make numbers work for people. As Accountancy Europe, we translate their daily experience from across Europe to inform the European policy debate. We do this in the areas in which our profession can contribute most, namely: Sustainable Finance, SMEs, Tax, Reporting and Audit.

Good decisions start with reliable information. Qualified accountants measure, disclose and add credibility to organisational data to support decisionmakers in the public and private sectors. They provide the transparency, trust and integrity that help markets function. They are, as such, essential for the smooth functioning and integration of European capital markets.

CFA INSTITUTE

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion of ethical behavior in investment markets and a respected source of knowledge in the global financial community. Our aim is to create an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 170,000 CFA charterholders worldwide in 162 markets. CFA Institute has nine offices worldwide, and there are 158 local member societies.

EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

The EBRD is a multilateral bank that promotes the development of the private sector and entrepreneurial initiative in 38 economies across three continents. The Bank is owned by 69 countries as well as the European Union and the European Investment Bank. EBRD investments are aimed at making the economies in its regions competitive, well-governed, green, inclusive, resilient and integrated. This report was prepared with contributions by the EBRD's Local Currency and Capital Markets Development Initiative (LC2), which aims to promote more efficient and self-sustaining financial markets through the development of local capital markets and broader use of local currencies.

FEDERATION OF EUROPEAN SECURITIES EXCHANGES (FESE)

The Federation of European Securities Exchanges (FESE) represents 36 exchanges in equities, bonds, derivatives and commodities through 18 Full Members from 30 countries, as well as 1 Affiliate Member and 1 Observer Member.

At the end of January 2020, FESE members had companies listed on their markets, of which are foreign companies contributing towards European integration and providing broad and liquid access to Europe's capital markets. Many of our members also organise specialised markets that allow small and medium sized companies across Europe to access capital markets; companies were listed in these specialised markets/segments in equity, increasing choice for investors and issuers. Through their RM and MTF operations, FESE members are keen to support the European Commission's objective of creating a Capital Markets Union.

FESE is registered in the European Union Transparency Register with number 71488206456-23.

8. Overview and assessment of recommendations provided by the European IPO Task Force in 2015

RECOMMENDATION 1

Create a more flexible regulatory environment for small and mid-cap quoted companies, also known as "Emerging Growth Companies", including lowering the barriers to entry and the cost of equity capital.

1.1 Encourage a diverse and attractive funding base in European public markets for companies of all sizes

		INITIAL ASSESSMENT 5 YEARS LATER			LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT, WHY?	STILL DESIRED?	NO/LOW HIGH
1.1.1. Provide companies with access to different regulatory, administrative & fiscal environments appropriate to their financing needs at different stages of growth	All (EU, MS, Industry)	X	This was partially addressed in the review of the Prospectus Regulation but as highlighted in the report more needs to be done.	Yes	High
1.1.2. Provide a central information portal for companies with information on the different mechanisms for raising capital cross-border	EU and Industry	X	No sponsoring organisation	Yes, the European Electronic Access Point project under the Transparency Directive is welcome in this regard[E]	Medium
1.1.3. Enable investment into less liquid stocks (e.g. creation of indices with equal weight per company, not just market cap)	Industry	X	No sponsoring organisation	Yes	Medium
1.1.4. Create an SME asset-class definition for national markets that would serve to calibrate appropriate rules for listed companies of different sizes	EU and MS	X		Perhaps superseded by the SME Growth Market	Low
1.1.5. Public acknowledgement by EU policymakers of the link between IPOs and growth and commit to improvements in European listings vis-a-vis rest of the world	EU	Yes		Yes	High

1.2 Promote the concept of "think Small First" in EU financial regulation affecting Emerging Growth Companies

		INITIAL ASSESSMENT 5 YEARS LATER			LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
1.2.1 Support alternative exchange markets (SME Growth Markets) with more flexible and calibrated requirements than the main markets[F]	All	√		This was actioned, although there is room for further flexibility	Low
1.2.2. Ensure maximum flexibility to the market operators of Growth Markets	EU and MS	Partially		See above. More flexibility on listing rules support better functioning and the integrity of the market, e.g. with regard to the publication of half yearly financial reports on SME debt-only issuers or concerning the free-float requirements.	Low
1.2.3. Enable the adoption of IFRS for SMEs in Growth Markets	All	X	Not addressed by the European Commission	There is a need for harmonisation of accounting frameworks, as multiple standards should be avoided to improve consistency. At the same time, there is a need for proportionate requirements that consider the size of different companies.	Low

1.3. Revise EU financial regulation to reduce administrative costs by 30-50 %costs

		INITIAL ASSESSMENT 5 YEARS LATER			LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
1.3.1. Redefine the purpose of EU capital market regulation to serve the end users, being both companies and investors	EU	Partially addressed by the CMU agenda.		Yes	Medium
1.3.2. Create a separate new impact assessment, which considers the cumulative effect of EU regulation on issuers	EU	Partially, in the CMU 'Call for Evidence' in 2015-16		Yes, as part of continuous assessments.	Low
1.3.3. Revise the Prospectus Directive and simplify the disclosure requirements for secondary public offers	EU	Partially achieved		Still issues to be looked at, e.g. further alleviations on risk factors.	Low
1.3.4. Eliminate the requirement for issuer lists in MAR and simplify the reporting of managers' transactions	EU	Partially achieved		Not very impactful. Still issues to consider to strike the right balance between reducing burdens and maintaining market integrity.	Low
1.3.5. Simplify remuneration and related party transactions in the Shareholder Rights proposal/exempt EGCs from some provisions	EU	No, the requirements have not been simplified and additional ones have been introduced.		Yes	Low

[E] Please see chapter two

[F] Amend the Anti-Money Laundering Directive to allow companies on alternative markets to rely on market disclosures
Exempt SME Growth Markets from the 2014 Audit Regulation & Directive and the remuneration provisions in the Shareholder Rights Directive

RECOMMENDATION 2

Relax constraints that restrict investors' ability to access IPO markets & to invest in venture capital / private equity

2.1 Create a single market for retail investors to directly access public equity markets cross-border in Europe

		INITIAL ASSESSMENT 5 YEARS LATER			LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
2.1.1. Create greater flexibility for retail investors who wish to be treated as professional investors (qualified investors)	EU	X	This measure was not introduced in any of the legislative proposals under the CMU Agenda.	Yes	High
2.1.2. Lower the costs of execution-only investment accounts by removing barriers to the development of platforms providing direct access to retail investors, such as cross-border brokerages or exchanges	All	X		Yes, but need for more evidence-based feedback.[G]	Medium/ High
2.1.3. Create a more level playing field between pack-aged and non-packaged products available to retail investors	EU and MS	X		Yes[H]	Medium
2.1.4. Improve private pensions in Europe by encouraging EU citizens to take greater responsibility for their own retirement investments and removing barriers to the creation of a portable personal pension account	EU and MS	Partially		Partially achieved via the PEPP Regulation, but lack possibility, for at least one alternative option, to allow direct investments into equities listed on RM.[I]	Medium/ High on equity investment as default option

2.2 Ensure that EU legislation does not restrict investors' ability to invest

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
2.2.1. Create a separate new impact assessment, which considers the cumulative effect of all EU financial regulation 2009-2014 for its impact on investors	EU	Partially, in the CMU 'Call for Evidence' in 2015-16		Yes, as part of continuous assessments.	Low
2.2.2. Eliminate undue restrictions in EU and national legislation (e.g. SOLVENCY II, gold plating in UCITS), which restrict institutional investors' ability to invest in IPO markets	EU and MS	Ongoing		Yes. Review of equity capital charges under Solvency II may bring many of the smaller EU markets on the radar screen of investors.[J]	High, in particular Solvency II
2.2.3. Encourage institutional investors to invest in less liquid stocks through more diversified indices	Industry	X		Yes	Low
2.2.4. Reassess how risk in long term, relatively illiquid, as sets is measured in order that prudential capital requirements reflect the characteristics of such assets	EU	Partially		Solvency II Delegated Acts were published to give long-term exposures a more appropriate risk-weight, but further work is expected to take place.	Low
2.2.5. Shareholder Rights Directive: ensure that investors and asset managers who already face appropriate transparency or disclosure requirements under existing EU legislation are not faced with additional burdens	EU	X	More requirements are now in place, including Article 51a in IFR (disclosure on investment policy for investment firms with more than 5% of voting rights)	Yes	Low

2.3 Promote investor confidence and understanding

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED ?	NO/LOW HIGH
2.3.1. Encourage national corporate governance codes, and different market segments for quoted companies, which are designed to help companies and investors understand what to expect at different stages of the company's development	EU and MS	There is opportunity to encourage the debate. The QCA is currently researching benefits smaller companies can obtain from adopting suitable governance codes.		Yes [K]	High
2.3.2. Develop pilot programmes such as those run by UK Financial Reporting Lab to test disclosures	EU and MS	Possibly via the creation of the EFRAG reporting lab.[L]			Low

[G] Please see chapter four on Investment Savings Accounts.
[H] Please see chapter two.
[I] Please see chapter two.
[J] Please see chapter two.
[K] Please see chapter two.
[L] Please see chapter two.

RECOMMENDATION 3

Improve the ecosystem of IPOs and market structures to better serve companies at different stages of growth and different types of investors.

3.1 Increase connectivity and encourage better dialogue between European companies and their investors, including end investors, both pre and post IPO

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
3.1.1. Help companies connect with the right prospective investors at least a year before the IPO[M]	Industry	Yes. Many exchanges run initiatives and projects in the pre-IPO space.			High
3.1.2. Empower companies with the right to identify their shareholders and ensure an efficient and cost effective cross-border shareholder identification system in Europe	EU and MS	Yes, via the SRD II implementing regulations.[N]			Low
3.1.3. Promote Stewardship Codes for institutional investors such as fund managers to communicate their investment approach to companies and to report their activities to their beneficial owners (pension funds, retail investors)	EU and MS		Only partially, e.g. the Financial Reporting Council is looking has worked on this. The industry Initiatives run bythe European Fund and Asset Management Association (EFAMA) which has integrated stewardship principles into a revised version of its Code of External Governance.Invest Europe also has Professional Standards.[0]		Low

3.2 Improve the provision on analyst research and/or other third-party business information services regarding small and mid-cap companies

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
3.2.1. Compare the effectiveness of the alternative national approaches and different providers highlighted in the ECSIP report on business information services	EU and industry	X		Yes, and this should be assessed taking into account the overall debate around the overall debate around MiFID II's inducement rules.[P]	High
3.2.2. Investigate the pros and cons of different options for the most cost effective and user friendly provision of central or regional information on smaller companies to small-cap investors	EU and industry	X		See above and the project to create a central database for all issuers – small and large)[Q]	High

3.3 Improve the "after-market incentives" for brokers

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
3.3.1. Tick sizes in MiFID II should be designed with the needs of smaller companies duly taken into account; we would encourage the development of a pilot project to test this	EU and industry	X	MiFID II introduced mandatory tick sizes produced by ESMA for companies of all sizes.	For SMEs, there could be benefits in allowing tick sizes to be set in a way that is better suited to the local conditions of the markets [R]	High
3.3.2. Review ESMA CSDR proposals on settlement fails that could fine trading in illiquid stocks more heavily than in liquid ones	EU			Could be considered in the upcoming CSDR review.	Low

3.4 Set up an EU industry expert group of advisers that would develop proposals as to how to reduce the cost of supplementary services faced by issuers

		INITIAL ASSESSMENT 5 YEARS LATER			LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
EU and Industry	EU and Industry	Partially		Final SME Growth Markets Regulation to set up an experts group which will look at all the sectorial regulation affecting SMEs access to finance and SMEs investing.	High

[M] Arranging pre-IPO days at an early stage, involving companies and investors, without intermediaries being present.
Promoting the creation of investor clubs, shareholder associations, online platforms / fora and organisation of roadshows during which companies and investors can meet.
Investigating greater central public access to lists of investors investing in given sectors (e.g. biotech) – possibly as a public-private venture – in order for European companies to be able to target potential cross-border investors.
Improving the IPO allocation process to include a sufficient quantity of investors with long-term investment horizons, in addition to those that make short-term trades.

[N] Please see chapter two

[O] Please see chapter two.

[P] Please see chapter one.

[Q] Please see chapter two on the European Electronic Access Point.

[R] Please see chapter one

RECOMMENDATION 4

Create an equity culture in Europe, including the provision of education and non-legislative initiatives

4.1 Develop proposals for new pricing structures which align incentives, and balance the long-term health of the company post IPO performance with the need to get the IPO away

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
	Industry	X	X	Yes	Low

4.2 Promote the financial education of both investors and companies as users of capital markets

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
4.2.1. Promote the financial education of investors [S]	All	Local initiative e.g. by exchanges		Yes [T]	Medium
4.2.2. Promote the financial education of companies [U]	All	Local initiative e.g. by exchanges		Yes [V]	Medium
4.2.3. Encourage the development of best practice guidance for companies when dealing with advisers and comparing services provided[W]	All	Partially		Yes	Medium

4.3 Enhance the availability of EU data and research by standardising and improving data collection, in order to enable both companies and investors to understand the comparative costs and benefits of different services provided by capital market participants

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
4.3.1. Standardise and measure the total and relative costs of raising equity (the costs of the IPO process and the ongoing costs thereafter) in order to enable both intra-EU comparisons, as well as between the EU and US / Asia etc)	All	Several studies and research have been published on this topic but no concrete actions.		Yes	Medium
4.3.2. Measure the importance of raising capital via the stock exchange and IPOs to the EU economy	All		Not measured but the importance of public funding is at the core of the CMU agenda	Yes	Medium
4.3.3. Measure companies' as well as investor confidence in EU capital markets	All	Industry initiatives, e.g. Invest Europe Global Investment Decision Makers Report		Yes	Medium
4.3.4. Standardise and collect better data on the underlying ownership of EU companies	All	Industry initiatives e.g. of European Issuers.		Yes	High
4.3.5. Conduct comparative research into the real risks associated with investment into EU small and mid-cap companies	EU and industry	X		Yes	High
4.3.6. EU to adopt goal that stock market capitalisation should account for 75% of GDP by 2025	EU	Yes, Europe's average stock market capitalisation of EU GDP is now approximately 75%		Ongoing issues of attractiveness of public capital markets in EU, in respect of other financing options and alternatives in other regions (US). Therefore, the EU should set it-self a goal of reaching a 100% stock market capitalisation of EU GDP by the end of the next legislative term (2024).	Low

[S] Educate investors in basic financial concepts, starting in schools. Educate investors as to how capital markets operate, and the characteristics of different investment structures (UCITs v direct shareholdings, equity v debt, etc. Educate investors in dealing with different financial advisers (banks, fund managers, independent financial advisers, etc).
Support investors' organisations in the provision of best practice and education programmes (e.g. fundamental analysis of company shares, mock-up investments for practice).

[T] Please see chapter two.

[U] Educate companies on how capital markets operate and the features of different funding options (e.g. ELITE programme re difference between equity listing v private equity v debt raising etc). Educate companies in what to expect from and how to deal with financial advisers (investment banks, other corporate finance advisers, financial communications, etc

[V] Please see chapter two.

[W] Model sub-underwriting agreement as recommended by UK Institutional Investor Council Report Charter for broker-issuer relations, including e.g. 10 top questions for companies to ask their broker Online guide to going public developed by the European Commission, EuropeanIssuers, and FESE Information on how to proceed with formalities for cross-border employee share ownership.

RECOMMENDATION **5**

Improve tax incentives for investments into IPOs and equity more generally

5.1 Develop proposals for new pricing structures which align incentives, and balance the long-term health of the company post IPO performance with the need to get the IPO away

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
5.1.1. Extend tax allowances available for debt financing to equity financing e.g. tax deductibility for advisory and other costs		X	Member States issue	Yes. Rebalancing the current bias towards debt financing should be at the core of CMU.	High

5.2 Provide tax incentives to encourage investment both for the longer-term and Emerging Growth Companies

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
5.2.1. Provide fiscal incentives for investors who take a long-term investment as opposed to short-term trading view: (e.g. no capital gains tax relief for holding for less than 12 months; staggered CGT relief on length of holding; exemption from CGT for illiquid Emerging Growth Company shares)	MS	X	Member States issue	Yes	Low
5.2.2. Avoid the introduction of financial transaction taxes or at least exempt transactions that support Emerging Growth Companies	EU and MS	Ongoing -, some MS introduced a tax.		Yes [X]	High
5.2.3. Provide fiscal incentives for companies offering employee share ownership/ stock options	MS	X	Member States issue	Yes	High

5.3 Ensure consistent tax treatment and exchange of best practices

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
5.3.1. Ensure consistency of tax policies over several years in order to ensure continued, long-term investor appetite and confidence	MS	X	Member States issue	Yes	Medium/ High for reclaim of dividend tax
5.3.2. Use the open co-ordination method to share best practices in terms of tax incentives	EU	Ongoing -, some MS introduced a tax.		Yes [Y]	Medium
5.3.3. Allow companies to file accounts created using IFRS for SMEs for their tax returns	MS	X	Not addressed at EU level	Yes	Medium

5.4 Ensure consistent tax treatment and exchange of best practices

	INITIAL ASSESSMENT 5 YEARS LATER				LEVEL OF PRIORITY
SUB-RECOMMENDATIONS	DIRECTED TO	ACHEVIED?	IF NOT WHY?	STILL DESIRED?	NO/LOW HIGH
5.4.1. Provide a more consistent approach to the taxation of cross-border employee share options schemes, which moves to taxation upon exercise or deferment of the tax	MS	X	Member States issue	Yes	Medium
5.4.2. Investigate barriers to the establishment of cross-border brokerage platforms for retail investors	EU	X.		Yes [Z]	Low
5.4.3. Investigate barriers to the creation of a portable personal pension for individual EU citizens	EU	√	√	Yes	Medium
5.4.4. Investigate barriers to cross-border taxation for investors in UCITS and other EU fund structures	EU	√	√	Yes, e.g. in the context of double taxation of withholding tax.	High

[X] Please see chapter four.

[Y] Please see chapter four.

[Z] Please see chapter four.

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ACCOUNTANCY EUROPE.

CFA Institute

European Bank for Reconstruction and Development

FESE

CONTACT US

ADDRESS:
116 avenue de Cortenbergh
1000 Brussels

PHONE:
+32 2 551 01 80

WWW.FESE.EU
INFO@FESE.EU