

Reduce Administrative Burden – Mobilise Capital of Retail Investors

Comments on the Consultation “Building a
Proportionate Regulatory Requirements to Support
SME Listings”

Introduction

In Germany number of stock listings remain on a low basis and number of stock listed companies fell since the financial crisis. This indicates, that the potential of financing growth, innovation and employment by a stock listing is not effectively realised.

Therefore, Deutsches Aktieninstitut welcomes the initiative of the European Commission to identify barriers for small and medium sized companies accessing public markets for equity and debt.

Against this background Deutsches Aktieninstitut recommends:

- 1.** Many of the problems discussed in the consultation results from the extension of the scope of the Market Abuse Regulation to issuers on MTFs. This has significantly reduced the flexibility of stock exchanges to design SME segments that balance the particular needs of SMEs and investors while at the same time having in mind local or regional specifics. Therefore, it is still our most favourable way out to redraft the MAR accordingly.
- 2.** Any reduction of bureaucracy, however, will not only help SMEs but would be for the benefit of all stock-listed companies. Thus, rules which do not fulfil the aim to enhance investor protection and which solely cause administrative burden should be abandoned for companies irrespective of the size.
- 3.** The improvement of regulation must go hand in hand with seeking ways to improve the investor base for SMEs seeking access on capital markets. Countries that rely more on the capital markets in their pension system tend to have bigger investment pools that can and will also be channelled to SMEs. The EU could thus promote steps in that direction, e.g. to provide more incentives for share investments in the European Personal Pension Product.

Answers to Selected Questions

1.1 Questions on challenges faced by public markets for SMEs

Question 1. In your opinion, what is the importance of each of the factors listed below in explaining the weakness of EU SME-dedicated markets? Please explain and describe the current situation of SME-dedicated markets in your own jurisdiction or countries of operations:

Note that we refer to the public markets for equity only.

In Germany, there are a number of SME-dedicated markets: E.g. Scale (Frankfurt), m:access (Munich), Mittelstandsbörse (Hamburg/Berlin) or BW Mittelstandsinitiative (Stuttgart). As far as we know, only a few of these markets aim for the status of a European regulated SME Growth Market or are already registered as such. Nevertheless, SME-dedicated markets in Germany does not deliver its full potential so far: Take for example the number of listed companies on Entry Standard in Frankfurt (substituted by Scale in March 2017) which peaked in 2013 with 161 companies and then fell to 121 companies at the beginning of 2017. In the same period the number of listed companies on the Stockholm First North market, featured as SME market, increased by nearly three times.

Therefore, from a German perspective, we fully support the EU-Commission's aim to strengthen capital market access especially for SMEs.

Question 2. What are the main factors that can explain the low number of SMEs seeking an admission of their shares or bonds to trading on EU public markets? Please illustrate by providing evidence from your own jurisdiction:

Deutsches Aktieninstitut conducted a study among stock listed companies with a market capitalisation of less than EUR 1 bn. and experts familiar with the capital market business. The study offers a detailed look on the challenges of stock listings and evaluates potential alleviations. The study referred to public markets for equity.

As main challenges SMEs mentioned low share turnovers (low liquidity), low analyst coverage and a lack of institutional investors' interest in their shares. In addition, survey participants pointed to a decline of the German ecosystem, especially a low number of investment banks willing to support IPOs with a market capitalisation of less than EUR 100 million. Furthermore, it turned out that SMEs face increasing problems to find investors, which are able to assess properly the business model of small potential issuers as well as the industry they are active in.

Besides these difficulties, survey participants expressed concerns on significant and increasing compliance costs. One of the main cost drivers are the reporting obligations, e.g. annual reports and IFRS accounting, followed by the costs for the compliance with corporate governance and market abuse rules. In this regard the majority of companies is of the opinion that the extension of the Market Abuse Regulation (MAR) to SME dedicated markets licenced as MTF has impeded stock listing significantly. Regarding the new rules concerning the availability of research under MiFID II, companies also made clear that this would harm strongly the attractiveness of a stock market listing.

In addition, companies complained about the bad reputation, as capital markets and stock exchanges are labelled often as “casino” or “place of speculation” by the public and in the media. This might be another important reason, why especially family owned companies refrain from an access to capital markets.

Finally, most companies are not aware about the concept of SME-Growth Markets. This indicates that there is a lot of Information work to do in order to make companies familiar with this concept.

Question 3. What are the main factors that inhibit institutional and retail investments in SME shares and bonds? Please illustrate by providing evidence from your own jurisdiction:

Lack of institutional investor’s interest in their companies is – according to our survey – one of the main challenges for SMEs listed on public markets for equity. For foreign investors this is – at least to some extent - a natural consequence of transaction costs economics. Entering into a foreign market thus is more attractive for larger investors that in turn rather focus on bigger companies.

Therefore, it is important to strengthen domestic institutional demand for SME shares by creating or encouraging investment vehicles able to invest in broad range of companies without facing language and/or cultural barriers and having a natural advantage in analysing SMEs from the home market. Thus, promoting SME capital market access has much to do with the general level of investment in shares of the home country population. This would help both big companies and smaller ones.

Ideally, these vehicles should be part of the occupational or private retirement system, as e.g. pension funds are in their capacity of long-term investors very suitable for share investments. In order to increase share investments via the retirement system adequate incentives should be provided, especially in countries like Germany where capital markets play a minor role in the old age provisions and where retirement income relates largely on the pay-as-you-go-system. In this regard, we deem two steps of utmost importance: Firstly, granting state subsidies for occupational or private pension should depend on a minimum quota invested in shares. Secondly, distortions followed by the different tax treatment of debt and equity should be removed, as the double taxation of equity – on corporate and on

investor level – discriminates equity financing vis-à-vis debt financing. The European Commission could encourage member states to take action in these fields.

Question 4. In your opinion, what participants of the ecosystems surrounding local exchanges for SMEs are declining the most? Please illustrate by providing evidence from your own jurisdiction:

All market participants listed in the question above are important elements of the ecosystem. For all of them decreasing IPO activity or decreasing number of SMEs listed on public markets for equity mean a decreasing attractiveness of their business model. Therefore, it is difficult to assess whether some of them are more declining, and others to a lesser extent.

In order to solve the problem of a declining ecosystem it is crucial to revive the IPO market so that businesses in that field will become more appealing again. Against this background, fostering domestic institutional investments via pension systems is crucial (see our answer to question 3). To alleviate stock listing it is also helpful to decrease administrative burdens stemming from too much bureaucracy (see our answer to question 2).

Question 5. What are the main reasons behind the decline of the ecosystems surrounding the local exchanges? Please illustrate by providing evidence from your own jurisdiction:

See our answer to question 4. Most important are the described measures to increase IPO numbers on markets for public equity: Incentives for using more shares in the pension system and debureaucratization of stock listing. Raising IPO numbers will attract the specific service providers mentioned above and foster the ecosystem.

1.2 Questions on specific regulatory barriers

Question 6. Given the considerations mentioned above, do you consider that the criteria used to define an SME Growth Market should be modified? Please explain your reasoning:

We agree with the Commission's reasoning to align the definition with other regulatory initiatives on EU level. Furthermore, the definition should reflect legislation in other jurisdictions, especially the US JOBS Act, which sets a higher threshold of approximately EUR 1 bn. It could be also worth to consider an automatically inflation adjustment of the threshold.

Question 7. Should the market capitalisation threshold of EUR 200 million defining SMEs under MiFID II be. Please explain your reasoning.

We suggest a threshold of EUR 1 bn. For the reasons, please refer to the answer of question 6 above.

Question 10. Please indicate whether or not you agree with the following statements regarding minimum requirements and obligations of key advisers for firms listed on SME Growth Markets. Please explain your reasoning and provide supporting evidence on the costs associated with the appointment of a key adviser. If appropriate, please specify the mission and obligations that should be placed on key advisers at EU level:

Although the requirement of a key adviser mandate is quite usual in the institutional settings of SME dedicated markets in Germany we think that this should be left to the flexibility of exchange providers and not been made mandatory by law.

Question 12. In your opinion, are there merits in introducing harmonised rules at EU level on voluntary transfer of listing from a regulated market to an SME Growth Market? Please explain your reasoning. If you answered affirmatively, please indicate examples of rules and their purpose:

For this case, we do not see any need for action of the legislator. As rightly stated above the transfer happens from the tighter regulated market to a lighter regulatory standard. We do not understand, why adopting a lighter standard, which the legislator and investors acknowledge as appropriate, should involve any problems.

Question 13. In your opinion, should the transfer of issuers from an SME Growth Market to a regulated market be. Please explain your reasoning and supporting arguments/evidence. When relevant, please indicate appropriate thresholds or possible incentives for SME Growth Market issuers to move to a regulated market:

The transition from SME markets to regulated markets is associated with additional regulatory requirements that will cause additional costs for issuers. Therefore, this transition should not be made more burdensome. This means e.g. for the EU Growth Prospectus, that issuers on SME growth markets should not have to produce a full prospectus when transferring to a regulated market (unless they fall into another regime or if there is an offer). Transitional arrangements should be put in place to that effect. Otherwise, when required to produce a full prospectus as requirement to transfer to regulated markets would thwart the benefits of the EU Growth Prospectus. Many issuers would prefer to produce a full prospectus, although not required for a listing on a SME Growth Market, in order to avoid this requirement with the decision to transfer their shares to regulated markets.

Question 14. Please indicate whether you agree with the statements below. Regulatory alleviations should be restricted to. Please explain your reasoning:

We think that the principle “same market segment, same rules” should apply. Investors rely on the fact that companies of the same segment comply with the same rules. A differentiation between different size classes would increase complexity for investors. For larger companies, crossing the threshold, these markets would be less attractive, if they are not allowed to benefit from the regulatory alleviations any longer.

Question 15. For each of the provisions listed below, please indicate how burdensome the EU regulation associated with equity and bond listings on SME dedicated markets is. Please explain your reasoning:

In general, there is a growing concern among listed companies that the duties resulting from the Market Abuse Regulation (MAR) have become too detailed and burdensome. Listed companies are still confronted with a high level of legal uncertainty, as e.g. central legal definitions remain unclear. This generally makes a public listing less attractive, which was also evidenced by our study.

The extension of the scope of the MAR to trading platforms beyond regulated markets has substantially increased the level of regulation. Though this has been justified with the argument of investor protection, it has nevertheless increased the hurdles for unlisted companies to access organised capital markets. We would therefore plead to (re-)exempt companies on MTFs, including SME Growth Markets, from the general disclosure regime of Market Abuse Regulation. Exchange providers should have the flexibility to set rules in accordance with the interest of their companies and investors on these platforms, providing adequate transparency while reducing the administrative burden.

Regarding the concrete proposals under consideration to lighten the regulation (see questions below) it is important to note that they by-and-large point to general problems of the MAR, i.e. legal uncertainty and bureaucracy. Thus, we are still of the opinion that any improvement in this regard should also benefit larger companies, irrespective whether they are listed on regulated markets, SME Growth Markets or SME dedicated MTFs. However, if for whatsoever reasons such improvements are only granted for SME growth markets we will not oppose it.

Question 16. Does the management’s transactions regime represent a significant administrative burden for SME Growth Markets issuers and their managers?

This MAR requirement is difficult to comply with for all companies on all markets (including regulated markets), but is particularly burdensome to smaller companies, because they regularly lack the in-house legal capacities to cope with legal uncertainties (e.g. regarding the correct identification of transactions being in scope, the point of time of notification, elements of notification).

The problem is aggravated, because MAR significantly increased the number of transactions that have to be notified, introduced the duty to compile a list of

closely associated persons and significantly increased sanctions for violating against MAR compliance duties.

Question 17 a). The time limit (i.e. currently 3 days) for PDMRs and person closely associated to notify their transactions to the issuer should be extended.

Although firms are obliged to publish managers' dealings within three working days of the date of a trade, the persons caught by the regime also have the same three-day period to inform their firms (Article 19(1) and (3)). In order to avoid compliance problems, this requirement should be amended so that PDMRs are required to notify issuers within three working days but also to ensure that the issuer has sufficient time to meet its own compliance duties. Thus, the issuer deadline should be extended to four or five working days after the transaction or alternatively two working days after the notification of the PDMR to the issuers (which remains the three-day period).

Note also here, that this kind of amendment of the MAR would also ease larger issuers' compliance with the complex regime of managers' transactions.

Question 17 b). The threshold (i.e. EUR 5,000) above which managers of SME Growth Markets Issuers should declare their transactions should be raised.

The regulatory rationale of the duty to notify managers' transactions is to signal investors whether or not PDMRs believe in a positive development of the business model so that investors can adjust their behaviour accordingly. However, for having a real signalling value the volume of the transactions needs to be significant in relation to the regular remuneration of the PDMR. Deutsches Aktieninstitut therefore has always called for higher thresholds.

Note also here, that the rising the threshold would also be useful for larger issuers.

Question 17 d). The trading venue should be made responsible for making public the managers' transaction.

The current regime obliges PDMRs to notify the issuers which in turn has to notify the public. Notification must be distributed across Europe, although MTFs (and thus also the European Growth Market) are not in the scope of EU Transparency Directive.

In order to limit the burden of compliance, issuers on SME Growth Market should be allowed to only notify Managers' Transactions on their website. We would prefer such a solution to a mandatory notification by the trading venue or the NCA because it is likely that both will not be costless for issuers.

Question 17 e). The time limit for issuers to make management's transactions public (or notify the NCA when the latter is made responsible for making the

manager's transaction public) should start as of the date the transactions have been notified to issuers (and not as from the date of transactions).

We strongly support such an approach. It is even more important than giving PDMRs more time to notify – see our response to question 17a.

The approach should also be considered for regulated market where the issuers face the same unnecessary compliance problems.

Question 18. What is the impact of the alleviation provided by MAR for SME Growth Market issuers as regards insider lists? Please illustrate and quantify, notably in terms of reduction in costs (one-off and ongoing) /in time spent (number of hours)/in number of people needed (in full-time equivalent) resulting from the alleviation:

As the SME growth market exemption in MAR was not applicable due to delay of MiFID II application until 3 January 2018, for the time being it remains impossible to say what is its impact.

However, if there is benefit from the alleviation of Art. 18 (6) it will be very small. In essence, the alleviation just changes the point of time when an insider list has to be prepared. The issuer on a SME Growth Market has to provide the competent authority with a full-fledged insider list upon request whereas issuers on regulated markets have to prepare the list whenever an inside information evolves. Because there are very detailed provisions on the information that has to be included in an insider list (e.g. the private email address and the exact point of time when a person on the list has to know inside information) every issuer is well advised to prepare these lists on an ongoing basis.

Note also that before the MAR there was no obligation to compile insider list on the existing MTF growth markets.

Question 19. Please explain your reasoning and provide supporting arguments/evidence, in particular in terms of savings/reduction in costs, or in terms of additional costs, that any change of the currently applicable rules may induce:

The requirement to create and keep an insider list in accordance with the provisions of Article 18 of MAR is onerous and burdensome for small and mid-cap companies given the level of resources available to such companies and the purpose for which insider lists are kept. In particular, being required to include an insider's place of birth, personal phone number and email address is especially onerous, as such details are not required to be kept by organisations in some EU member states. Moreover, this could create potential problems relating to personal data protection rules.

As pointed out in our response to Q 19 the SME growth market exemption in MAR in practice does not offer a more proportionate regime, because issuers are well advised in having sufficient systems and procedures in place to produce an insider list if requested by the competent authority. This leads such issuers to establish costly internal systems and / or processes, which increases administrative burdens.

Therefore, we believe that companies on SME Growth Markets should be altogether exempted from the requirement of creating and maintaining insider lists, which would take into account the level of resources available to SMEs and how this will affect them as a result.

Question 20. Justification of the delay in disclosing inside information.

Tailored, simplified and clearer rules on delaying the disclosure of inside information for SME Growth Markets Issuers should be considered to ensure the success of SME Growth Markets. Such a clarification would – by the way – also help issuers on regulated markets, because they face similar problems.

Question 22. Disclosure requirements for plain vanilla bond issuers.

In general, tailored, simplified and clearer rules on disclosure of inside information for SME Growth Markets Issuers regarding bonds should be considered to ensure the success of SME Growth Markets. Having in mind that due to limited liquidity in bond markets for smaller issuers the volatility of the bonds prices tend to be higher. It has therefore be avoided that too much information will be regarded as price sensitive from regulatory point of view.

From our perspective there are only general events that deserve publication: a) information that will likely impair the ability to repay debt and b) – with smaller significance – dramatic changes in ratings. From our perspective, a clarification that the notification duty is limited to these kind of events would be helpful.

Question 27. Please explain your reasoning, notably on the advantages and disadvantages of the introduction – at the EU level – of minimum free float requirements. Specify appropriate criteria and thresholds if you consider that such minimum free float rule should be introduced and determined at EU level.

Free float requirements should be left to the discretion of the exchange providers as they could best assess the right balance between market liquidity and the difficulties to comply with such requirements.

Question 28. Please describe any regulatory barriers to institutional investments in SME shares or bonds listed on SME Growth Markets or MTFs:

As mentioned above in our answer to question 4, it is very important to mobilise money for listed companies by expanding capital market orientation of old age

provisions. Especially the US example shows the amount of capital raised by e.g. pension funds that also invest in IPOs, already listed shares of SMEs and growth companies.

Question 32. You are kindly invited to make additional comments on this consultation if you consider that some areas have not been covered above.

Please include examples and evidence:

Finally, we would like to reiterate on our central points regarding the design of SME Growth Markets which from our impression point to inconsistencies in the general debate on SME finance.

1) Much of the discussions on potential alleviations for the EU Growth Market segment has the character of “repair work”. From our perspective the main issue is that the revision of MAR has extended the scope to issuers on MTFs and thus also on issuers on future SME Growth markets. This has significantly reduced the flexibility of stock exchanges to design SME segments that balance the particular needs of SMEs and investors while at the same time having in mind local or regional specifics. Against this background, it is still our most favourable way out to redraft the MAR accordingly.

2) If a redraft is not possible, or feasible from a political standpoint, the legislator should address topics that cause unnecessary bureaucracy for listed companies although the benefits from an investor protection perspective are not obvious. This holds particularly true for the detailed obligations on insider lists and managers’ transactions, but does not apply to same extent for the duty to publish inside information and even less for the prohibition of insider dealing and market manipulation. Any reduction of bureaucracy, however, will not only help SMEs but would be for the benefit of all companies. Thus, the definition of SME Growth Market segment should only be the starting point for a broader review of the MAR provisions in order to make capital markets more attractive in Europe.

3) For companies of all sizes the MAR has created legal uncertainties in a number of areas which still await clarification. To a certain extent, this is rooted in unclear wordings of the level 1-text of the MAR. The resulting legal uncertainty is particularly problematic because at the same time the level of sanction has been increased dramatically and disproportionately. Higher legal uncertainty and higher expected sanctions in case of violating unclear rules create a vicious mixture for companies that are interested in capital market finance. Thus, besides the provision themselves the legislator should have a second look on the sanctioning regimes.

4) The improvement of regulation must go hand in hand with seeking ways to improve the investor base for SMEs seeking access on capital markets. This is, however, often rather a task of member states. Capital market involvement of the population (the capital market culture) varies across the EU in particular because of

differences in the design of the systems for old age provisions. Countries that rely more on the capital markets in that respect tend to have bigger investment pools that can and will also be channelled to SMEs. The EU could thus promote steps in that direction, e.g. to provide more incentives for share investments in the European Personal Pension Product.

Contact

Dr. Norbert Kuhn
Head of Corporate Finance
Deutsches Aktieninstitut e.V.
Senckenberganlage 28
60325 Frankfurt am Main
Phone + 49 69 92915-20
Fax + 49 69 92915-12
kuhn@dai.de
www.dai.de

