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# A EUROPEAN REGULATORY STRATEGY FOR CAPITAL MARKETS IN THE POST-COVID ERA

## 1. INTRODUCTION

### THE NEED FOR EUROPEAN COMPANIES' MASSIVE RECAPITALISATION

**European companies will face difficult challenges in the next few years**. Most of them are affected by financial unbalances and business restrictions which threaten their very survival. Several informative reports are issued to analyse the consequences of the measures of the Covid-19 on the European Economy including publicly quoted companies. According to the European Commission (EC) Staff Working Document accompanying the Communication on the Next Generation Plan, between 25% and 35% of companies would experience a financing shortfall after exhausting working capital and liquidity buffers, respectively. In the adverse scenario, these shares could increase to 35% and 50%, respectively. This means that around 180,000-260,000 of European companies employing around 25-35 million employees could experience a financing shortfall should the adverse scenario materialize. The corresponding liquidity shortfall to be covered could range between €350bn and €500bn in the baseline scenario, and between €650bn and €900bn in the adverse scenario[1].

A Mc Kinsey recent research shows the **devastating effect COVID-19 is having especially on European small and medium-size enterprises**, who employ more than two-thirds of Europe's workforce and contribute substantially to Europe's economy. Due to the pandemic, one fifth of businesses expect to default on loans and lay off staff. A substantial part of them could shut down by the September 2021, from 39% to 77% according to different scenarios about the evolution of the economy in the next months[2].

The EC Economic Forecasts Autumn 2020 identify **a slow recovery path for the European area**, where the expiration of many extraordinary measures, taken to limit economic and social effects of the crisis, **will create further pressures on companies' resilience and, more generally, on the stability of financial markets.** According to the European Commission, EU GDP is expected to have shrunk by about 7,8% in 2020 before rebounding by 4,2% in 2021 and by 3% in 2022. This implies that the output in the European economy would barely return to pre-pandemic levels in 2022. Moreover, due to the resurgence of COVID-19, the impact on business activity will last for longer than initially expected. Even without being able to quantify solvency risks, it is obvious that the longer than previously expected duration of containment measures, the negative impact on balance

[1] European Commission, Staff working document, Identifying Europe's recovery needs, 27.5.2020 SWD (2020) 98 final https://ec.europa.eu/info/sites/info/files/economy-finance/assessment_of_economic_and_investment_needs.pdf

[2] Mc Kinsey research: https://www.weforum.org/agenda/2020/11/covid-19-coronavirus-pandemic-europe-business-smes-economics/

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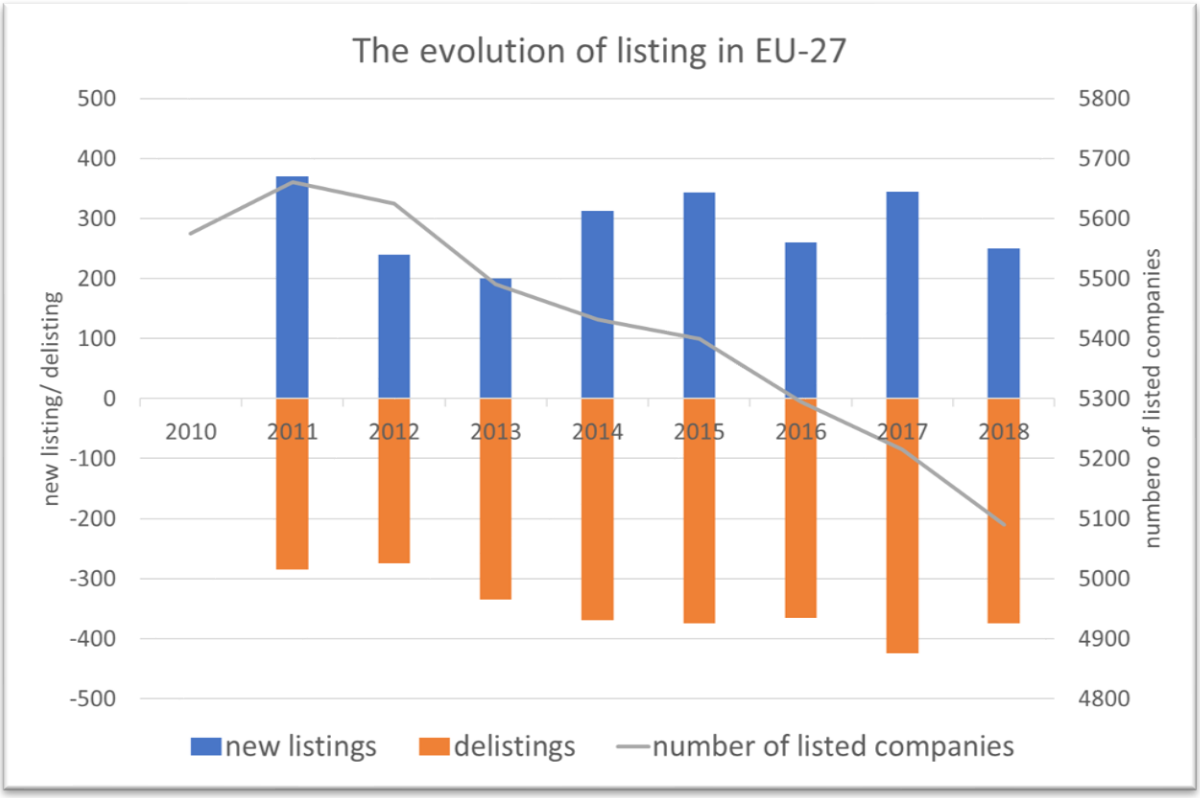
sheets, and reallocation needs, all tend to imply a higher number of bankruptcies: in this perspective, the Bank for International Settlements estimates that bankruptcies among advanced-economy firms could rise by more than 20% in 2021 (from the 2019 baseline). At the same time, the increase in bank lending, largely backed by state guarantees, provided vital support to preserve corporate operations and has helped to avoid widespread bankruptcies. However, as banks' risk tolerance has diminished, they may tighten credit standards to enterprises as state guarantees are withdrawn. In this context, the possibility of financial market stress cannot be excluded in the euro area and the rest of the EU. In particular, the banking sector could be tested by markets as higher corporate defaults would lead to an increase in non-performing loans[3].

As correctly stated in the EC Staff Working Document**, the ability of the European economies to return to growth depends on the resilience and adaptability of the private sector**. The recovery of the European economy, supported by the EU Next Generation Plan, will require, also to more resilient companies, huge investments, and complex restructuring activities to restore competitiveness and to meet the ambitious goals of higher sustainability. A substantial stock of investments will be necessary only to recover from their collapse by about 11% in 2020, a fall like to the one recorded in 2009. The basic investment needs due to the pandemic impact, the additional investment needs to stabilise the public sector capital stock to GDP ratio, **the investment needs for the green transition and digital transformation and the needs for strategic investment were estimated by the EC amounting to at least €1.5trn in 2020 and 2021.**

The critical current situation of most of the business sectors, which will be likely to continue for the following months, if not years, and the need for a radical transformation of companies' activities in line with the Next Generation Plan **require a strong recapitalization of companies** supported by vibrant and competitive capital markets. Equity repair needs, due only to the lockdowns implemented during the pandemic have been estimated between €720bn and €1.2trn for 2020.[4]

Companies need, overall, a **substantial increase in their risk capital to overcome the current financial unbalances** and to ensure that the incentives and funds provided by the public sector according to the Plan will result in a stronger sustainable and inclusive growth. This support can rely on the huge stock of savings available in Europe, substantially increased during the pandemic crisis: household saving rate increased to 23.9% in the second quarter of 2020 from 15.6% in the previous quarter, consolidating a spectacular jump with respect to the average 10% level in the last decade.

[3] European Commission, European Economic Forecast Autumn 2020, Institutional Paper 136, November 2020
[4] European Commission, Staff working document, Identifying Europe's recovery needs, 27.5.2020 SWD (2020) 98 final.

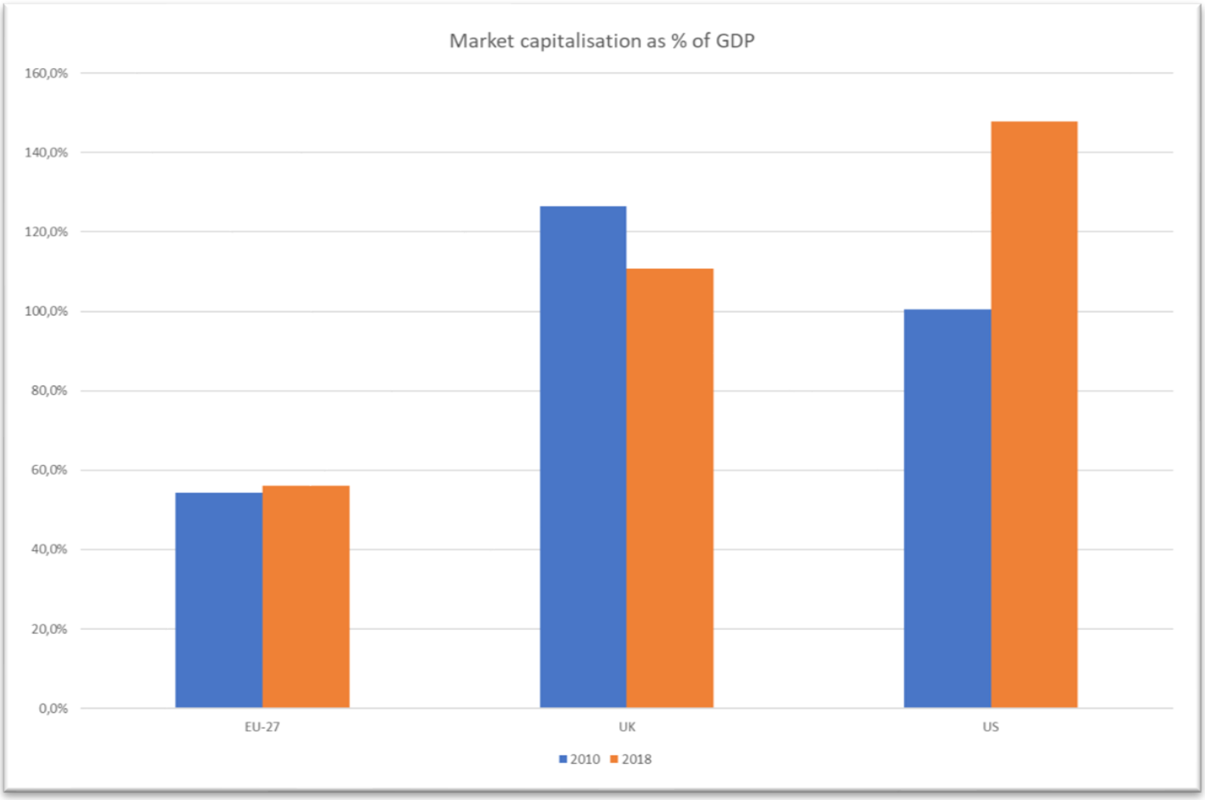


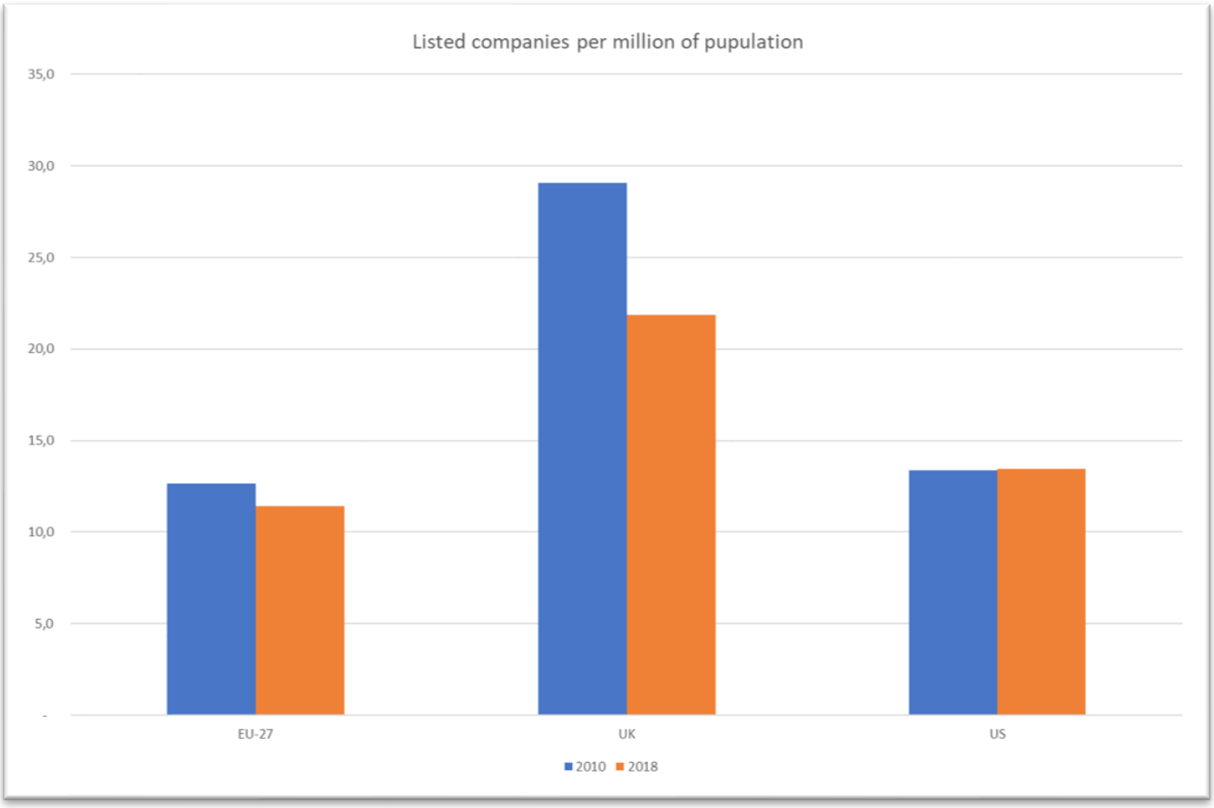

Source: Oxera

THE MISSING ROLE OF PUBLIC EQUITY MARKET IN EU

**A key role in matching companies' demand for risk capital with household savings supply should be played by "public" capital markets**, both regulated markets and MTFs, as only public markets can ensure effective price discovery mechanisms and liquidity provisions, necessary to allow also retail investor to access equity investment, directly or through institutional investors, and therefore to benefit from possible value creation by investee companies. At the end of 2020, it is estimated that there are more than 30 unicorns (private high-tech companies valued more than 1 billion dollars) incorporated in EU-27 countries: these companies have a current total value of about 60 billion dollars and are likely to go public in the next years.

In this perspective, the **current underdevelopment of the European public capital market**, but for UK, with respect to the real economy and its gradual decline in recent years, which was stronger than in other developed economic areas, is a structural problem to be addressed.




Source: Oxera

The recent study mandated by the European Commission to Oxera[5], aimed at identifying economic and technical barriers to the development of the EU primary and secondary equity markets, confirms this picture and underlines how **the costs of becoming a public company have risen considerably in recent decades:**

- in 2018, the **size of public equity** markets as % of GDP in the Euro area was about 55%, vs. 110% in UK and 150% in the US. With respect to 2010, size increased substantially in US (from 100% of GDP), while it was quite stable in EU-27 and declined in the UK (from 125%);
- the **number of listings** in EU-28, declined by 12%, from 7,392 in 2010 to 6,538 in 2018, while GDP grew by 24%; in EU-27 the decline in listings was slightly lower (by 9%, from 5,575 to 5,090), while GDP grew by 23%. In the US the number of listings increased by 5% from 2010 to 2018 (from 4170 to 4397) with a growth of GDP of 32%;
- in EU-27 **delisting** exceeded new listing in all the years between 2010 and 2018, but for 2011, and involved about 2,800 companies in the period. The number of delisting is constantly increasing while the one of new listing is more volatile;
- European listed companies are, on average, **larger and older** than in the other economic areas, showing a difficulty of the European market to attract small growth-companies;
- the **total (direct and indirect) financial costs of an IPO** are estimated to range from 5% to 15% of gross proceeds, even higher for those raising smaller sums (for example, the median reported cost for all listings on AIM Italia in 2019 was 18% of gross proceeds).

More generally, the European capital markets are playing a lower role in financing companies' risk capital than in the other main developed areas:

- **total capital raising through IPOs** and seasoned issues more than halved in Europe-27 from 2015 to 2019, while it increased by 20% in the US and was quite stable in UK. The divergence between Europe-27 and US is particularly evident for IPOs: the capital raised through new listing, quite similar in the two areas in 2015 ($31 billion vs. 39 respectively), constantly decreased in Europe-27, down to $11 billion in 2019, with an opposite trend in the US, jumping to about $70 billion in 2019, with the UK also facing a strong decline. As to seasoned issues, the identified evolutionary trends are less clear: nonetheless, evidence show a lower structural role of capital markets in Europe-27 than in the US and in UK. Those differences exacerbated with the current crisis, especially for IPOs: in the first 9 months of 2020, the United States has attracted most of the listing action, with a record of more than $100 billion of IPO proceeds, while European-27 IPOs have raised less than $9 billion and UK less than $3 billion, the lowest for both in at least a decade. While in 2020 European seasoned issues

[5] European Commission, Primary and secondary equity markets in the EU Final report, Oxera, November 2020 https://www.oxera.com/wp-content/uploads/2020/11/Oxera-study-Primary-and-Secondary-Markets-in-the-EU-Final-Report-EN-1.pdf

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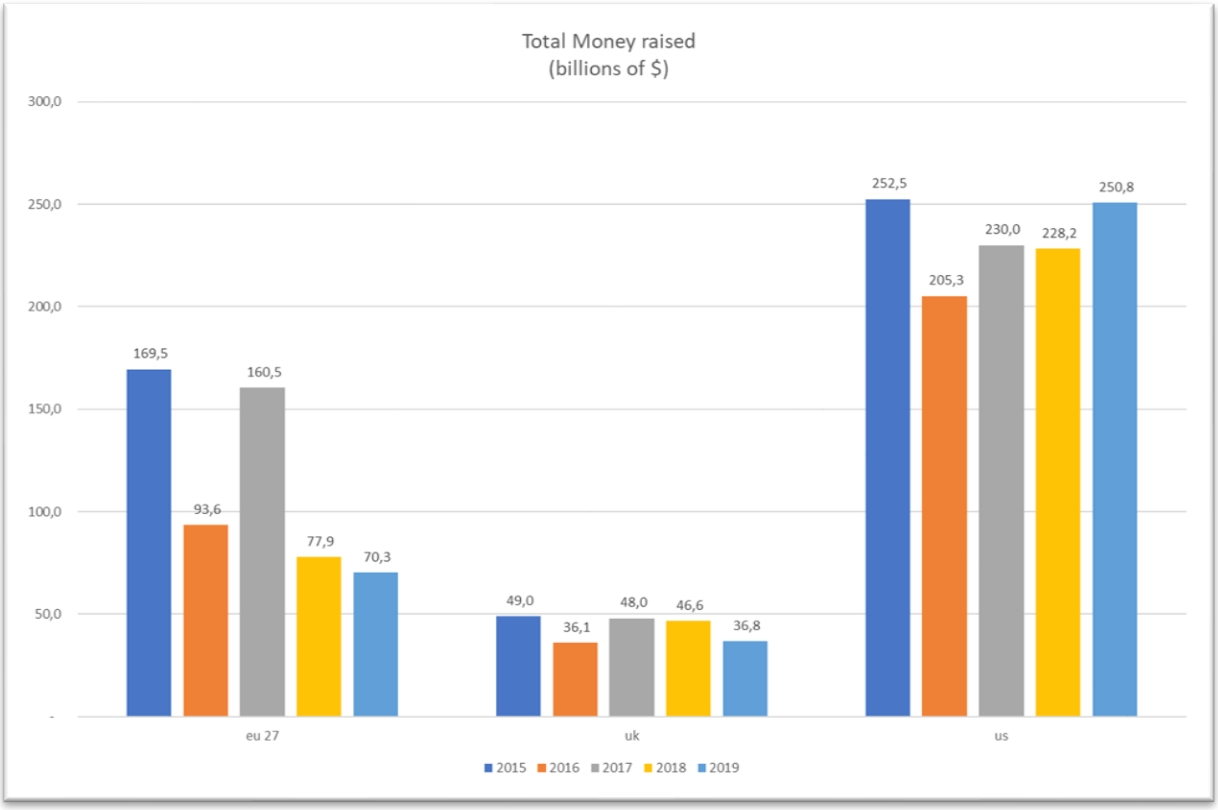
appear more resilient, showing a light increase with respect to previous years but still well under the level in the US market, which increased also in the last year;

- the weakness of the European capital markets is even more evident looking at **listing of so-called unicorns,** which represents the more dynamic component of the stock markets development. Between 2014 and 2018, 100 unicorns (85% of the total unicorns IPOs) went public in the US markets, while only 8 in Europe (of which 3 in the UK). Half of the 12 unicorns incorporated in European countries, who went public in that period, listed in the US to benefit from a more favourable regulatory framework and, more generally, from a stronger ecosystem.



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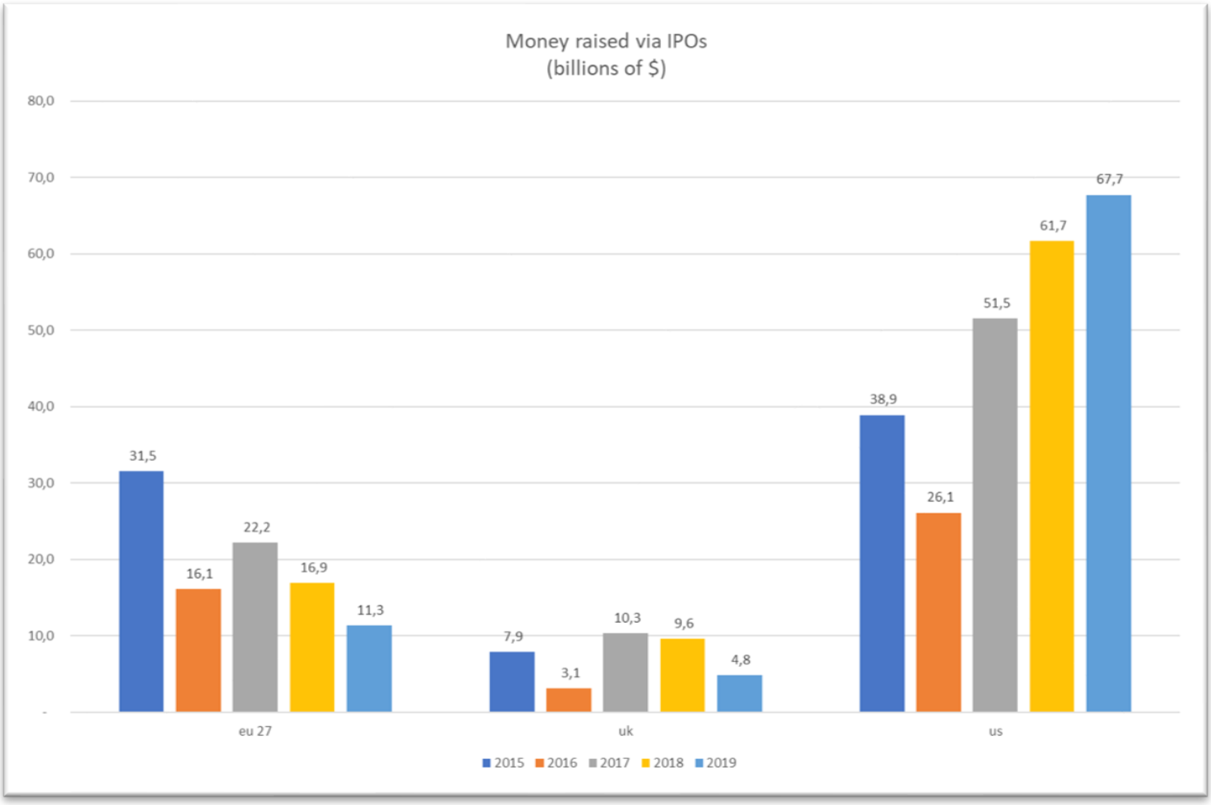


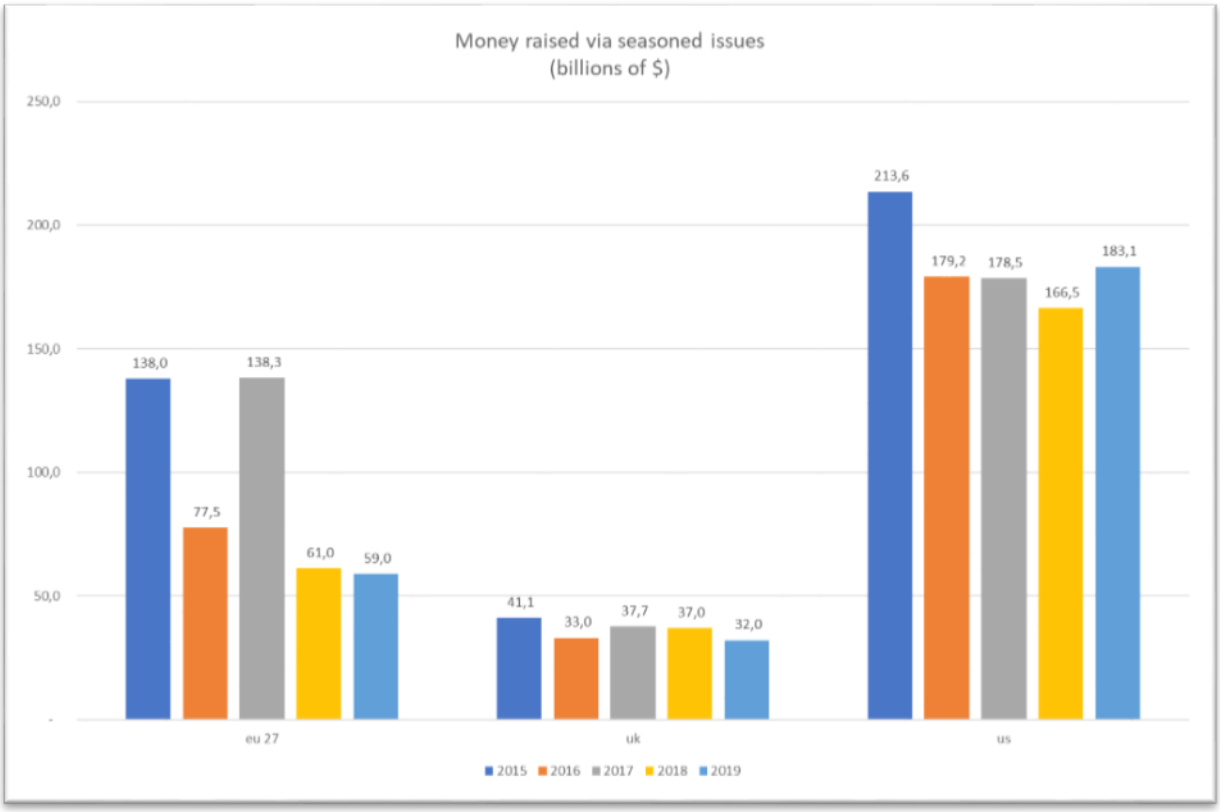


Source: Oxera

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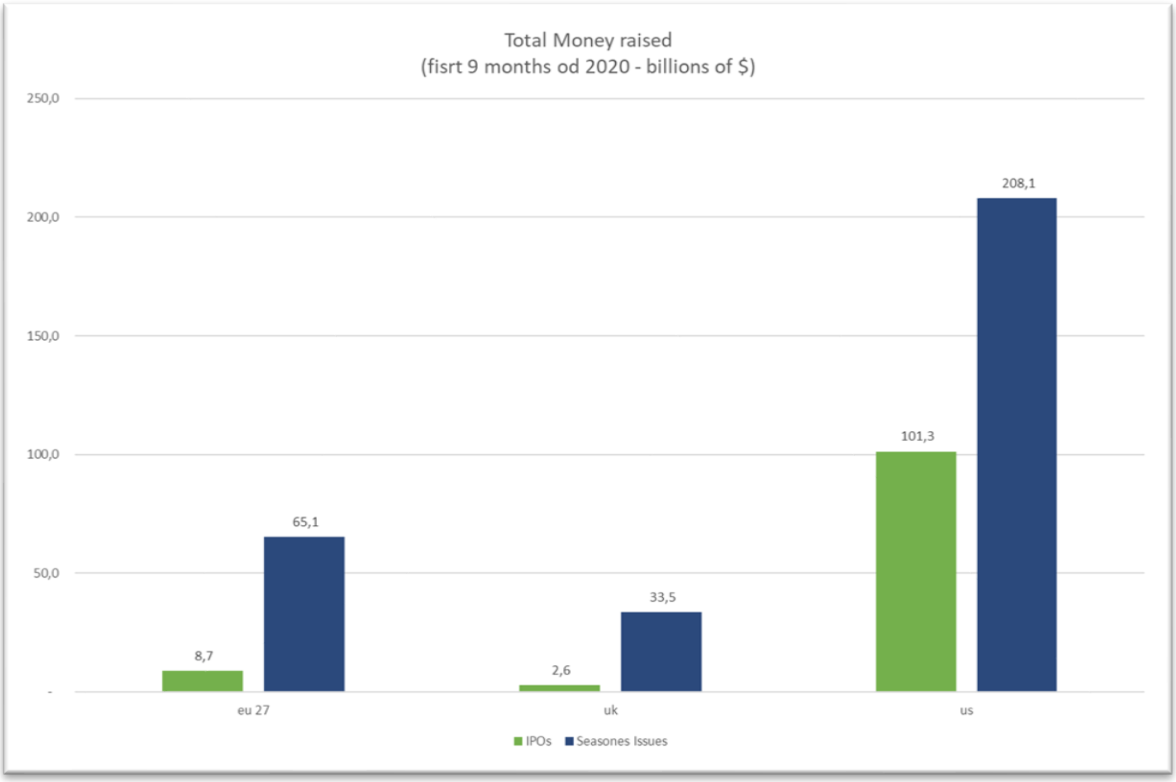


Source: Assonime elaboration of data reported in various PWC IPOs-Watch

Considering EU market trends and the current legal framework of the EU-27, the study also underlines the level of **fragmentation of the European capital markets** and identifies main challenges for the CMU project, which is far from being complete. “[Although] listing rules are largely harmonized in EU (…) differences across markets remain, including free float requirement, working capital, track records, when a prospectus is needed, and when major shareholders need to disclose information”.

According to the Oxera’s study, “while regulation may not be a primary driver for the decline in listings, the **regulatory costs associated with listing are particularly relevant for smaller issuers**, for which alternative private funding options may be more readily available”. Furthermore, Oxera’s study affirms that: “The main reasons cited in our issuer survey and structured interviews for voluntarily choosing to delist include the **challenges associated with meeting regular financial reporting requirements**; the **time and cost associated with compliance and administration**; **annual fees** paid to advisers, brokers and exchanges; and **requirements to disclose sensitive information**”. Consequently, the study argues that there is still room for “further **modernisation and streamlining of listing rules**, (…) especially for [but not limited to] smaller issuers”. For SMEs, the study therefore suggests “the **listing regime for SMEs** [to] be built from the ground up”, by redesigning disclosure

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obligation of smaller listed companies, on one side, and "enabling" investors, on the other side, seeking a right balance between regulatory burden and investor protection.

#### THE BREXIT CHALLENGE

The European policy should also take into consideration how Brexit could further negatively affect the ability of the European capital markets to face companies' needs. On one side, the **conditions for accessing the pool of liquidity and expertise of the London financial place will become more difficult**; on the other side, the **UK capital markets will be able to play a stronger competition** in attracting issuers and investors once the UK will regain full responsibility for its financial services rulebook. Meaningfully, the UK Government recently announced its determination to act early on this opportunity, launching an ambitious initiative aimed at encouraging more IPOs and new capital raising by listed companies in UK, by putting under discussion some consolidated principle of the European rules on capital markets. The **areas for reforms** – which focus on some of the main areas for possible EU reform identified in the Oxera's study – include possible relaxation of current rules concerning the conditions for listing (free floats, dual class share structures, and track record requirements) and for issuing a prospectus and other documentation (in particular, by companies that are already listed); a particular attention is paid to a possible relaxation of listing rules for the Premium segment. More generally, the UK Government is considering the opportunity to redefine the balance between investor protection, as currently implemented in EU, on one side, and incentives for companies to access capital markets, on the other side, in order to make the London financial centre more competitive in the attraction of the most innovative, growth companies.

### 2. AN EU POLICY STRATEGY FOR COMPANIES' RECAPITALIZATION

In this context, there is a **risk that policy making plays a pro-cyclical effect**, amplifying recession trends: the more financial markets are considered as in danger, the more the EU could be inclined to respond with more regulation and further information requirements for companies.

In our view, on the contrary, the European policy strategy should support companies in overcoming current difficulties and affording deep transformation of their activity. This should be done providing, on one side, a **stable regulatory framework** to allow medium-long term planning; on the other side, **incentives for a stronger access to capital markets** to rebalance their financial structure and to sustain necessary investments, including investments necessary to achieve the transition to a low-carbon economy.

#### STABILIZING THE REGULATORY FRAMEWORK

As for the stability of the regulatory framework, already deeply reshaped in the last years, we suggest the European Union **duly consider the timing of any further regulatory reforms,** so that companies can put all their energies and resources in the recovery (i.e. in restarting and reshaping their business activity) rather than in the compliance with new regulations.

We observe a contradiction between the need to develop capital markets as the objective addressed by the new CMU Action Plan and some new regulatory requirements that generate new burdensome obligations that listed issuers shall fulfil to be or remain listed. We believe that the scope of this inconsistency is increasing generating a broader gap between the regulatory framework and the needs of the users of those markets. As a consequence, the business environment is becoming more technical and complex for issuers not bringing the space to generate innovation and business activities in Europe. A good working eco-system is based on a solid basis of principles on which the pillars that are obsoletes shall be abandoned for the sake of consistency.

The new action plan on the Capital Markets Union: **"A capital markets union for people and businesses"** lacks consistency, with regards both to the timeline and the focus of the proposals, and the need for regulatory coherence, to avoid the proliferation of measures acting against the establishment of the CMU. These reflections were emphasised also against the background of the current crisis due to the COVID-19 pandemic.

Notably, we strongly recommend the EC **to reconsider the scope and contents of initiatives such as those on sustainable corporate governance and sustainable finance.** While we fully support the need for a stronger commitment by companies toward sustainability goals, we think that any new possible piece of legislation should avoid creating i) disincentives or obstacles to invest in an EU-incorporated company, ii) huge compliance costs on companies iii) huge legal uncertainty for companies and their executives and directors' iv) an unlevel playing field vis-à-vis third-country competitors.

Firstly, we consider that there is **no urgency to further regulate** on the topic of corporate governance, as the current framework defined by the recent **Directive on Non-financial Information Disclosure** and by the various, also recent, initiatives in sustainable finance already provide a valuable framework to incentivize companies to progress in this direction. In this framework, the **development of best practices**, both by individual companies and by corporate governance codes, is already going on and needs to be consolidated before introducing new rules.

This is true for a possible initiative on board members fiduciaries duties, with respect both to long-term sustainable orientation of companies' strategy and for the introduction of due-diligence obligations in their value-chains, which have been already strengthened by the new disclosure obligations on non-financial information. As a matter of fact, such disclosure rules, together with the implementation of the new **Shareholder Rights Directive**, are already pushing companies' boards to develop and implement policies on sustainability and are encouraging investors to critically evaluate those elements both in their investment decisions and engagement policies.

Secondly, the **need for a legislative proposal should be better defined**, based on further analytical works. As underlined in the responses provided by most of the academic and market community in the various consultations carried out by the European Commission this year on the topic, there is no clear evidence of a market failure or regulatory gaps which can justify binding and general policy measures.

A possible way to combine the political willingness to push companies toward more sustainability and the need for a gradual evolution in this direction could be rather found in the **adoption of a European Commission Recommendation to Member States about sustainable corporate governance**, as it already did for independent directors or directors' remunerations.

This approach, aimed to nudge the evolution toward sustainability, would be in line with the comply or explain principle adopted in the Non-Financial Information Directive, and could effectively complement the evolution of self-discipline and of individual companies' best practices already in place. It would also avoid creating, at least in this starting period, an artificial segmentation of the companies' sector, which will arise from the unavoidable limitation of its scope to some group of companies (larger, listed, etc.). For the same reasons, we recommend that, in the on-going revision of the Non-Financial Information Directive, the comply or explain principle will be maintained and that any extension of its scope will be carefully considered.

Finally, we consider that the regulations adopted under the Sustainable Finance Action Plan, namely **the Sustainable Finance Disclosure[6] and the Taxonomy[7] Regulations**, should constitute key drivers for financing the transition to a green economy and attracting new investors, including retail investors, and equity investments to EU companies and EU markets. Both regulations **should not constitute obstacles to the financing of companies or impose on them disproportionate additional burden** that would raise the costs of listing. In this regard, we consider that:

- the **dates of implementation of some of the new requirements stemming from these regulations should be postponed[8]** ;
- **better coordination between these regulations and the review of the NFRD should be sought** to ensure a fit for purpose reporting framework for both investee companies and institutional investors;
- and the technical screening criteria of **the Taxonomy Regulation should better integrate "in transition" and "enabling" activities**. Setting the bar too high will result in excluding a significant proportion of companies – and therefore of EU real economy – from investment flows.

For the very same reasons, implementation of the upcoming public CBCR requirement should be postponed, as European multinationals will be faced with additional burdens and require time to adjust to an unlevel playing field, especially since they have emerged weakened from the Covid-19

[6] Regulation (EU) 2019/2088 of 27 November 2019
[7] Regulation (EU) 2020/852 of 18 June 2020
[8] SFDR will apply as of March 2021 but the level 2 measures are not yet ready; the new reporting requirements of the Taxonomy Regulation will apply as of 2022 which doesn't leave sufficient time to companies to prepare themselves since the level 2 measures will be adopted at the latest in June 2021.

and need to focus on restarting the economy and safeguarding their markets. Public CBCR will put multinationals with European operations at a competitive disadvantage, by making potentially sensitive data (costs structure, profit margins), whether applied on a country-by-country or aggregated basis, available to non-EU competitors who are not subject to the same regulation. Competitive disadvantage means less markets, less investments and less employment. Consequently, disclosure of such information would help competitors engage in unfair competition with EU companies and making European companies easier targets for acquisitions.

We therefore believe that the commencement date for the public reporting on tax information should be postponed by at least one year and set not less than two years (instead of one year under the Portuguese Presidency's compromise) after the transposition deadline of two years. If enacted in 2021, the new reporting requirement will apply to the first financial year starting on or after the two years' transposition deadline, i.e. effective for financial periods beginning on or after 1st January 2026. Besides, in the first two years of application, information concerning EU-based operations should also be aggregated.

Moreover, provision should also be made for a safeguard clause which effectively ensures ownership of commercially sensitive information. The option to delay for 6 years only the public disclosure of this information under the Portuguese Presidency's compromise text would not resolve this, as the information would remain sensitive particularly for companies with stable business models and margins. We propose extending the 6 years' duration whenever necessary and ensuring that Member States first allow multinationals to omit information required to be disclosed where the disclosure would be prejudicial to the commercial position of the undertakings to which it relates and second provide that any dispute over the right to omit disclosure be settled by the relevant national jurisdictions.

**A NEW CAPITAL MARKET RECOVERY PACKAGE**

As for the **incentives for a stronger access to capital markets**, while this need is widely acknowledged by the European institutional bodies, the concrete initiatives put forward so far seem not in line with the level of ambitions and of the timeliness necessary to produce a substantive positive shock. The measures under adoption within the "Capital Markets Recovery Package" on the Prospectus and MiFID rules provide for only minimal adjustments to the current framework.

**Shortcomings of the Recovery Prospectus measures**

The measures adopted on **prospectus (Recovery Prospectus)** are not sufficient to produce relevant positive effects. First, they limit its **scope** to companies already listed from at least 18 months, while in our opinion secondary issuances should be fully exempted by the obligation to publish a prospectus as issuers already publish both periodical and on-going material information.

We also regret that the scope of the Recovery Prospectus is restricted to share issuance, while it should also apply for debt issuances as bond investors even require less information than equity investors for their investment decisions. Moreover, debt investors are not directly affected by the fate of the company – as compared to equity investors - and therefore the company insolvency risk is much lower.

Secondly, the new measures try to alleviate the burden on issuers mainly by reducing the length of the document (to no more than 30 pages), but they maintain a wide range of information to be provided, some of them are quite complex and costly to produce, such as the working capital statement and the risks factor that are specific to the issuer and the shares. Therefore, companies bear similar responsibilities as in the ordinary prospectus, exacerbated by the need to synthetize the information in a shorter format. Lastly, as for the approval procedures, shortening the approval of EU Recovery Prospectuses to 5 working days, do not solve the problem of current discrepancies in the actual implementation of the scrutiny procedures adopted by national competent authorities, which often have a longer informal phase (before the starting of the official procedure) and scrutiny criteria wider than those envisaged in the EU Regulation.

According to the EC the EU Recovery prospectus should aim at being "(i) easy to produce for companies that want to raise equity on capital markets, (ii) easy to understand for investors who wants to finance them and (iii) easy to scrutinize and approve for national competent authorities". However, we think that these should be the aims of the Prospectus discipline in general, and not only in a post-crisis environment.

Therefore, a strongly simplified Prospectus should be always the standard format of prospectus while the Recovery Prospectus should be more limited in its aims, and it should cover a substantially reduced set of information.

Considering the limited effects of the so far adopted alleviating measures, we suggest developing, through a fast-track procedure, a **more ambitious initiative for a new Capital Market Recovery Package**, with the aim of **establishing a comprehensive temporary discipline for facilitating access by European companies to capital markets.**

The general aim of such a discipline should be to facilitate both equity and debt capital injections into companies, via capital markets, starting from the evidence that companies' financing needs will be hardly met by the banking sector only, also due to the likely increase in non-performing loans following the crisis which will affect credit capacity namely to SMEs.

A first possible target could be to implement, the proposals advanced by the High-Level Forum on CMU and by the Next CMU High-Level Expert Group aimed at incentivizing IPOs by small-medium companies on regulated markets and on SMEs growth market. Both expert groups recommended SME and Mid-Caps (all publicly listed companies on any type of market whose market capitalization is lower than one billion euros) **could benefit from an alleviated regulatory regime, for a few years**

**after IPO** (so-called IPO transitional regime). Possible regulatory areas from which such companies could temporary opt-out include Prospectus, MAR, Take-over, Transparency, Shareholder rights: in these areas, specific waivable provisions should be identified on the basis of a systematic analysis of the most relevant regulatory obstacles to listing in the different types of market (regulated market and SMEs growth markets). The IPO transitional regime could be implemented as **a pilot program** for IPOs realized in a limited period after implementation (at least 3 years), in order to evaluate its effects both on SME and Mid-Caps new listings and on investors protection.

Further temporary alleviating measures, aimed to incentivize equity and debt capital injections in already listed and larger companies, could be envisaged in the area of **disclosure obligations**, by further simplifying the Recovery Prospectus and MAR (see Annex I on Proposals for general alleviations to regulatory requirements of the EuropeanIssuers' comments on the EU Commission's new action plan on the Capital Markets Union ), and in the **area of corporate law**, by streamlining the approval procedures for transactions aimed to strengthen companies' capital structure.

**Alleviations to MAR (for all companies)**

The legislator should seek ways to clarify (and narrow) **the definition of inside information** to make compliance more affordable for issuers and to better protect the possibility of delaying disclosure of issuers against abusive market practices. All the associations of EuropeanIssuers realized that the broad definition of inside information raised many problems for (i) the identification of when the information becomes an “inside information” and (ii) the risk to publish information not enough mature, therefore, companies must rely on the possibility to delay which is the natural counterweight of that broad definition.

There is an **interaction between the Transparency Directive,** where investors need to be informed at predictable points of time **and MAR,** where information needs to be disclosed immediately at the moment it may be deemed inside. This interaction is especially relevant for periodic financial information (annual and half yearly financial statements), where it is challenging to identify the exact moment when the information becomes "inside" and should therefore be disclosed. **Companies should be given more flexibility to avoid making premature disclosures of inside information.**

The management of the **insider list** is very burdensome due to all the information the issuer must gather to fill in the list. Article 18 paragraph 9 should be amended to ensure that only the most essential information for the identification purposes is included. Issuers should be given flexibility to determine which elements of personal data in the insider list are sufficient for that purpose.

The threshold for **managers' transactions** (above which issuers should report transactions) is currently too low, leading to too much administrative burden for listed companies. The threshold

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should therefore be raised from the current €5 000-€20 000 to €50 000. Furthermore, to alleviate the burden for listed companies, it should always be for the national competent authorities to disclose managers' transactions to the public. Clear guidance should be provided on what types of managers' transactions need to be disclosed, as well as the scope of the relevant provisions in the context of different types of transaction. Transactions that do not send market signals (e.g. inheritances, gifts) should be out of scope. Finally, transactions should be aggregated to make the disclosure as simple as possible.

**Sanctions** for market abuse must be proportionate regarding the nature of the breach of law but also sufficiently dissuasive to prevent market abuse. In some cases, they may be higher than the market capitalisation of companies (e.g. Poland and Bulgaria). The risk of inadvertent breach of MAR and associated administrative sanctions are seen as an important factor that dissuades companies from listing. Member States shall amend their respective national sanctions regimes to ensure that the amount of administrative sanctions reflects the specifics of the supervised market and is proportionate to the nature of abuse.