Targeted consultation on the listing act – BNP Paribas

BNP Paribas welcomes the initiative of the European Commission to take action in order to develop further the Capital Markets Union (CMU) and to first consult widely in order to adapt its current legislation. The consultation of the European Commission on the Listing Act: "making public capital markets more attractive for EU companies and facilitating access to capital for SMEs" is therefore both timely and necessary. We have therefore decided to answer in detail in our own name while also having contributed to the answer of professional bodies such as AFME and AMAFI.

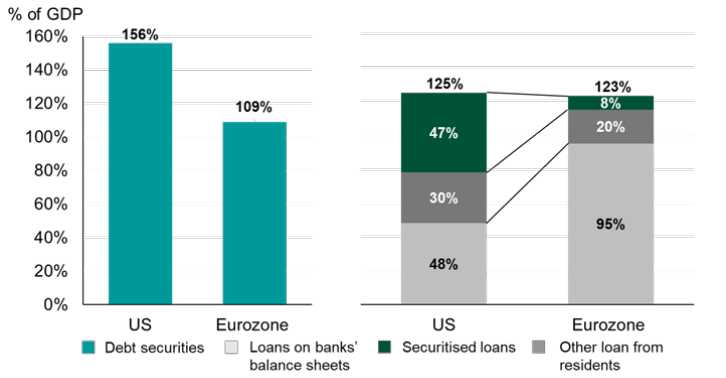
The answer of BNP Paribas reflects the recommendations and analysis of various segments of our investment banking franchise: ECM, DCM, brokerage, advisory, structured products[1]. Some answers also reflect the analysis of our asset management team. In our answer, we have endeavoured to reflect the interests of our corporate clients including SMEs which we advise and finance throughout the EU.

Even though BNP Paribas promotes CMU and the SMEs capacity to go public or issue debt when it makes sense for their development, it is worth remembering that there is a limit below which it is uneconomic and not ill-advised to push SMEs towards the public market. The public market imposes a high level of rules and requirements that can often be too costly for smaller companies but are justified to maintain trust and integrity in the market. The EU market now offers alternatives and a diversity of choices for SMEs, such as private equity and growth funds, which are sometimes better adapted to the profile of those companies.

Key messages

1. We would like to acknowledge the significant progress that has already been made in terms of providing a more harmonised capital markets platform through the implementation of a number of legal acts, such as the Prospectus Regulation (PR), the Market Abuse Regulation (MAR), the Market in Financial Instruments Directive (MiFID II) and Regulation (MiFIR), the Transparency Directive and the Listing Directive. Market participants have become used to them and stability of these rules is critical. We therefore advocate in our answers modest changes to improve the current regulation but no major revolution in the way European capital markets are regulated.

2. However, despite the long-standing stated goal of developing a Capital Market Union, EU Capital Markets remain underdeveloped (see graph). Such imbalance needs to be addressed urgently, as the European Commission estimates the additional investment needs in the relation to the green and digital transition at nearly €650bn per year until 2030. As banks finance 80% of the EU economy, this would require an amount of prudential capital which is well beyond EU banks' capacity to grow their capital base over the period (and anyway above supervisors' appetite for banks' balance sheet growth). Even if banks can get abundant funding from ECB and have access to deep and efficient funding instruments such as covered bonds, it does not solve the capital issue, all the more given the impact of CRR3 to be absorbed over the same horizon.



Sources: ECB, Federal Reserve, BNP Paribas calculations (data as of Q3 2021)

[1] Structured products are investment products distributed to retail investors. Such products offer the possibility of investing in a wide variety of asset classes (indices, shares, bonds, interest rates). Structured products are actively distributed in France in the form of stock Exchange Traded Securities, listed and easily accessible to investors, as well as distributed in the form of unit-linked insurance contracts. BNP Paribas Global Markets issues about 400 000 structured securities for the European Retail market every year.

3. In this context, the consultation on how to facilitate listing on EDU equity markets is very welcome. However, the terms of the first part of the consultation are very much focused on costs of prospectus preparation and of being listed which, in our opinion, does not represent the main obstacle to CMU. We consider that the EU markets are generally built on an adequate balance between the burdens and benefits of a listing whilst providing adequate levels of investor protection. Prospectus and disclosure costs ensure a high level of rigor and disclosure which are necessary for the trust of market players. In addition, it is not by lowering our standards in terms of investor protection and disclosure that we will achieve the objective of developing capital markets. The UK and particularly the US remain the most developed and liquid markets in the world, even though they tend to be the most onerous in terms of costs[2] compared to the EU. To have international and domestic investors investing more broadly in the EU markets, we need to have standards at par with those that investors are widely used to. For a company deciding to be listed, the balance must be positive between the benefits of raising finance from public markets and the costs and requirements. In this sense, it is important to focus on improving the benefits of being listed in terms of accessing a wide investor base, enabling quick equity and debt raisings and maintain investor interest and liquidity throughout the life of a listed company. The aim should be to get similar benefits, market efficiency and depth as those observed in other competitive markets, such as the US and the UK.

4. We still encounter a substantial diversity of local interpretation of regulation and of market practice, mainly due to the differing views of local regulators and market participants from jurisdiction to jurisdiction. EU regulation has to be as harmonised as possible and a consistency of approach is necessary. Everything that contributes to establishing European standards is positive for the attractiveness of the EU markets, whether equity or debt. In that regard, we would advocate amending and transforming the Listing Act Directive and make it a Regulation with the objective of having the same level-playing field for all companies in the EU. This strong political statement would demonstrate that the EU is advancing on CMU and is willing to promote the integration of its capital markets. In this sense, the new EU Listing Act should give ESMA an explicit mandate of (i) ensuring harmonisation and remove existing diverging interpretations for the ultimate good of efficient capital markets in the EU and (ii) promoting competiveness of EU markets vis a vis other financial centres (as the FCA in the UK). In the longer term, discussion could start as to whether ESMA should take direct responsibility for approving IPO prospectuses with the objective of giving one central point equivalent to the US SEC. Especially for Tech and new business models, the process of approval at one single point of approval could generate efficiencies and attract more cross border financing.

5. The evolution of EU regulation has to be considered in a broad context, taking stock of the requirement to be competitive with the US market and the UK market, post Brexit. International investors expect a well-established series of market practices and are used to the high standards they witness in other markets. EU regulation must therefore be consistent with regulatory practices applied in the US and the UK in order to offer an attractive and competitive European market. In particular, post Brexit, the UK is undergoing significant changes in its regulation of company listing in order to promote the City as a major financial centre (notably for dual classes of shares). The US markets are also very attractive for Tech and Biotech companies. International investors have choices in terms of cross border investment and will compare markets on the basis of investor protection standards.

6. The EU Tech industry is increasingly mature. Europe now has 321 unicorns, up from 223 in 2020. Providing a credible exit strategy on the public markets for these companies is a key element for the EU financial and technological sovereignty. In this regard, the EU market should be at par with the most developed markets in terms of financial tools and vehicles.
    - To remain a competitive market amongst the increasing number of prospective issuers desiring dual class of shares, such structures should be permitted and/or reviewed to determine the best EU approach. Those structures can be useful and are particularly important in certain situations, particularly for high-growth, innovative, founder-led companies looking to list. It has recently been authorised in the UK by the FCA and almost 30% of IPOs in 2017-2019 had dual-class structures.

[2] Please refer to the answer to question 3 : « Fees and commissions charged by investments banks in the EU are half those incurred/paid in the US (fees and commissions charged by banks represent 3.4% of total IPO cost for Euronext vs. 6.3% for Nasdaq based on Euronext and Dealogic data from 2015 to 2021. »

- We also want to retain a favourable environment for SPACs in the EU in a context of strong competition of US SPACs. SPAC is an innovative vehicle that allows private equity and public markets to work together. When benefitting from a high quality structure allowing for a proper alignment of interests, SPAC is a way to list a company of a certain size on the stock exchange that complements the traditional IPO process and establishes a potentially fruitful link with private equity. In the EU, we have been successful in having SPACs being listed in Paris, Amsterdam and Frankfurt and this should be encouraged with the existing disclosure requirements. Not having this tool available anymore, or in the same conditions as today, in the EU might contribute to a flow of EU companies to be tempted to be acquired by US SPACs and being therefore listed in the US (in spite of it not being their natural place of listing).

7. The objective of achieving an effective CMU cannot be reached without an initiative aiming at harmonising more deeply national corporate law, corporate taxation and bankruptcy regimes. Though there have been a lot of progress in these fields through the creation of the *Societas Europaea*, the recent restructuring regulation and efforts through the adoption of certain directives dealing with aspects of company law, we note that there are still substantial differences which may cause international investors to see the EU as a fragmented market. Harmonising or establishing a unique/common set of rules is a difficult path as it goes often against national legal culture but it may be a necessary journey to compete with unified markets such as the US or the UK, and it has proved to work in certain areas such as the prospectuses.

8. We consider that one of the major deterrents of going public is the imbalance in terms of disclosure between public and private companies. This imbalance should be reduced for the benefit of all investors and for the good of the public interest and this topic could be part of the debate as it has started to be in the US. We should create a level-playing field in terms of disclosure and requirements given the rise of private equity markets notably in terms of ESG and compensation.
   - There will be extra work around ESG in terms of what investors expect as ESG reporting. CSRD, the new disclosure for ESG, applies to all companies with more than 250 employees and listed SMEs. Issuers will have to provide more ESG disclosure. We welcome the development of a European ESG disclosure framework through CSRD and EFRAG, but warn against adding too much complexity for both public and large private companies. We also want to avoid ESG excesses constraints on SMEs and welcome the threshold of 250 employees.
   - Disclosure rules on compensation and benefits for executives and directors should be applicable for private companies to create a level playing field.

9. The most important striking objective for developing CMU is to develop a domestic investor base whether in bonds or equities to ensure high level of liquidity, a key component of mature and deep capital markets.
   - We have experienced a decrease in the capacity of EU institutional investors to invest in equity due to a number of trends: (i) the development of passive investment funds, (ii) the absence of pension funds in certain European countries and (iii) Solvency II because of its regulatory regime on equities for insurers. All of this has shrunk the proportion of EU insurance companies and other EU asset managers in the capital of EU listed companies and their participation in IPOs and ECM primary transactions.
   - Savings are quite abundant in Europe and investing those savings in equity or corporate debt could be an opportunity for retail investors. BNP Paribas is in favour of developing existing tools such as life insurance and employee shareholding funds to promote respectively debt and/or equity investment either directly or through funds. Our retail network is also keen to develop direct ownership in shares on the back of renewed interest in equities from a younger investor base.
   - The development of crossover funds could be another solution to strengthen the investor base. However, in the EU, there is still a clear distinction in the regulatory rules between investment funds in public and private markets. As a result, it does not enable asset managers to structure crossover funds that could invest in both private and public equity. We would advocate for a change in regulation to allow crossover funds. This would enable cross-fertilization between the buy side expertise developed on the private market and the public market, especially for Tech companies with new business models.
   - In order to create an environment ensuring that SMEs have access to capital markets, cornerstone and anchor investors are also a key element to develop and there is certainly a key

role to be played at the EU level by the EIB and other agencies such as KFW, CDC/ BPI France, CDP in Italy etc… to coordinate their policies and voluntarism on this topic.
- The Commission should encourage Member States to give specific tax benefits to specialised funds investing in SMEs, as has been done in the UK with the AIM.

10. EU legislation introduced new methods of financing equity research with MiFID II. This unbundling has had a clear downward impact on the amount of equity research published and the number of financial analysts employed by firms.
    - We however consider that there is unfortunately no way to reverse unbundling of equity research. BNP Paribas encourages all types of research, whether independent or not as it is an important component of the decision-making process for investors. At this stage, we are in favour of sponsored (issuer-paid) research as it gives better access to investors, ensuring more liquidity and provided they are framed with the necessary precautions. It is also important that new sources of revenues of research, including academic research, find public funding through the EU. We must encourage in the EU, post Brexit, the weight of academic research around financial markets that is deep and thorough in the UK universities. In addition, more and more research providers are developing analysis on ESG matters, corresponding to very strong demand from investors.
    - Conversely, on the basis of our experience in equity research, BNP Paribas believes that the unbundling rules of MIFID II to FICC research provided by sell-side analysts should be removed, as it is a fundamentally different product to equity research for which the regulations were really initially targeted.

11. BNP Paribas believes that the deeper development of the European market in HY securities is being constrained by MAR and to a lesser extent MIFID legislation in Europe. MAR makes it very difficult for arrangers of debt securities to get high quality feedback from investors in advance of launching a full offer of securities because many (potential) investors are unable or unwilling to be wall-crossed during the early marketing phase of a (potential) transaction, in the process known as 'pre-sounding'.

12. To develop the CMU, we should consider all the technological innovation such as digitalisation, artificial intelligence and machine learning. Covid has accelerated electronic format practices. The dematerialisation of prospectus, makes it possible to reinforce investor protection by offering them more fluid and more rapidly accessible information. On the other hand, the increasing size of the prospectus is probably also due to digitalization. EU law is progressively introducing machine-readability formats for both financial and non-financial reporting and as the ESAP project will ensure the accessibility of in-scope information in a digitalised format. Technology can provide cost-efficient solutions to improve the provision of equity research and to disseminate information. By automating some stages of the information production process, the cost of producing research may decrease. This cost efficiency can help facilitate the provision of equity research for SMEs. Asset managers should benefit from the lower cost of research production and can use the analytical insights to support their investment decision-making, making it less costly (from a due-diligence perspective) for them to invest in SMEs. Unified use of plain English such as what the SEC has adopted with its EDGAR data base is an example of what can be achieved in terms of a central data base.

13. ESG is a topic that is absent from this consultation despite it being a very important topic of disclosure for investors and of regulations in the EU. This is an increasing concern for SMEs which may not have the size and sophistication enabling them to publish this information without incurring extra costs. This is still a developing area in the EU and standards of disclosure between what will affect asset managers and issuers should not be on a diverging path.

14. Another point that is absent from the September 2021 CMU Action Plan and which is very important for the financing of SMEs is the topic of securitisation. Securitisation must be developed as an important instrument to develop the European markets and the CMU, notably by allowing banks to free up capital that they could reinvest in SME lending. Securitisation in Europe has been used for healthy risk transfer from banks to educated investors, and should be given an important role in the post-Covid recovery toolkit. However, we believe that it is still under developed and under used due to excessively strict regulations in the EU. There is consensus among experts about what is needed to unlock the market:
    - Recalibrate capital charges applied to senior tranches, in line with their risk profile,
    - Improve the Significant Risk Transfer Assessment process to make it swift and flexible,

- Upgrade eligibility of senior STS tranches in the LCR ratio,
- Simplify disclosure requirements for private transactions.

Making progress is key to avoid a situation where prevailing regulation and supervision continue to supress the necessary transformation of the European economy. This technical subject requires pooling the expertise across the various authorities involved and a coordinated effort to rebuild the securitization ecosystem that can deliver results. We urge the Commission to accelerate the revision of the Securitisation Regulation, as well as the revision of prudential requirements for banks and insurance, in the context of the current revisions of CRR3 and Solvency II.

Paris, February 2022