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COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union

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Subject:	COMMISSION DELEGATED REGULATION (EU) .../... of 13.12.2018 amending Commission Delegated Regulation (EU) 2017/565 as regards certain registration conditions to promote the use of SME growth markets for the purposes of Directive 2014/65/EU of the European Parliament and of the Council

Delegations will find attached document C(2018) 8442 final.

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Brussels, 13.12.2018
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COMMISSION DELEGATED REGULATION (EU) .../...

of 13.12.2018

amending Commission Delegated Regulation (EU) 2017/565 as regards certain registration conditions to promote the use of SME growth markets for the purposes of Directive 2014/65/EU of the European Parliament and of the Council

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Broadening access to market-based sources of financing for EU companies at each stage in their development is at the heart of the Capital Markets Union (CMU). Since the launch of the Capital Markets Union Action Plan, the EU has made considerable progress to increase the sources of funding as firms gradually scale up, and make market-based finance more widely available across the EU. New rules are already in place to boost EU venture capital funds' (EuVECA) investment in start-ups and medium-sized companies. Together with the European Investment Fund, the Commission has also launched a Pan-European Venture Capital Funds-of-Funds programme (VentureEU) to boost investment in innovative start-up and scale-up companies across Europe. New rules on prospectuses have already been adopted to support companies raising money on public markets for equity and debt. For small companies and mid-caps wishing to raise money across the EU, a new EU growth prospectus is being created. In addition, to increase access to finance for start-ups and entrepreneurs, the Commission has proposed a European label for investment-based and lending-based crowdfunding platforms ('European Crowdfunding Service Providers for Business').

However, more needs to be done to develop a more conducive regulatory framework supporting access to public funding for Small and Mid-sized Enterprises (SMEs). This should be achieved in particular by promoting the SME Growth Market label created by the Markets in Financial Instrument Directive II (MiFID II)¹ and striking the right balance between investor protection and market integrity on the one hand, and avoiding unnecessary administrative burdens on the other.

In its Mid-term Review of the Capital Markets Union Action Plan² published in June 2017, the Commission strengthened the focus on SME access to public markets. In this context, the Commission has committed to publishing *'an impact assessment that will explore whether targeted amendments to relevant EU legislation could deliver a more proportionate regulatory environment to support SME listing on public markets'*.

Newly listed SMEs are a key motor of new investment and job creation. Recently listed companies often outstrip privately-owned companies in terms of annual growth and workforce increase. Listed companies are less dependent on bank financing and benefit from more diversified investors, easier access to additional equity capital and debt finance (through secondary offers), and a higher public profile and brand recognition.

However, despite the benefits of stock exchanges listings, EU public markets for SMEs are struggling to attract new issuers. There are many factors driving SMEs' decision to go public and investors' decision to invest in SMEs' financial instruments. The impact assessment³ shows that public markets for SMEs face two groups of challenges: (i) on the supply side, issuers face high compliance costs to list on public markets; (ii) on the demand side, insufficient liquidity can weigh on issuers (due to higher costs of capital), on investors (that can be reluctant to invest in SME in the first place due to low liquidity levels and related volatility risks) and on market intermediaries (whose business models rely on customers order flow in liquid markets).

¹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU

² Communication from the Commission on the mid-term review of the capital markets union action plan ({SWD(2017) 224 final} and {SWD(2017) 225 final} – 8 June 2017)

³ Impact Assessment number

The Commission decided to put forward a legislative proposal together with a Commission Delegated Regulation that will bring technical adjustments to the EU rulebook in order: (i) to reduce the administrative burden and the regulatory compliance costs faced by SMEs when their financial instruments are admitted to trading on an SME growth market, while ensuring a high level of investor protection and market integrity and (ii) to increase the liquidity of equity instruments listed on SME growth markets. The Commission's proposal for a Regulation⁴ will bring targeted changes to the Market Abuse Regulation⁵ and the Prospectus Regulation⁶. The Commission Delegated Regulation will amend the SME growth market framework, a new category of multilateral trading venues (MTFs), created by MiFID II.

MiFID II states that the objective of SME growth markets should be *'to facilitate access to capital for smaller and medium-sized enterprises'* and that *'Attention should be focused on how future regulation should further foster and promote the use of that market so as to make it attractive for investors, and provide a lessening of administrative burdens and further incentives for SMEs to access capital markets through SME growth markets'*⁷.

However, the impact assessment that preceded this Commission Delegated Regulation shows that the take-up of the SME growth markets is constrained by two regulatory barriers:

- (i) An SME growth market is currently defined as a Multilateral Trading Facility, where at least 50% of issuers are SMEs. Under Directive 2014/65/EU, SME equity issuers are defined as a company that had an average market capitalisation of less than EUR 200 million on the basis of the end-year quotes for the previous three calendar years. The current definition of a non-equity SME issuer under Commission Delegated Regulation (EU) 2017/565 refers to the 2003 Commission Recommendation concerning the definition of micro, small and medium-sized enterprises⁸. This definition of non-equity SME issuers is not adapted to small companies issuing bonds on MTFs. Although these companies can be considered SMEs as compared to larger companies issuing debt on public markets, they often do not meet the criteria set out in the 2003 Recommendation. If the definition of non-equity SME issuer is not well-calibrated, it will be more complicated for MTFs to register as SME growth markets. As a consequence, companies will not be able to benefit from potential alleviations granted to SME growth market issuers;
- (ii) On the one hand, SME growth market non-equity issuers are required to publish half yearly financial reports. On the other hand, under the Transparency Directive⁹, regulated market issuers issuing bonds with a denomination per unit above EUR 100,000 (which are placed with professional investors) are not subject to the same publication requirement. This requirement can be burdensome for non-equity issuers.

⁴ Reference number of the Proposal for a regulation

⁵ Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation)

⁶ Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market

⁷ Directive 2014/65/EU ('MiFID II'), recital 132

⁸ A non-equity issuer shall be deemed an SME provided that, according to its last annual or consolidated accounts, it meets at least two of the following three criteria: (i) an average number of employees during the financial year of less than 250; (ii) a total balance sheet not exceeding EUR 43 million and (iii) an annual net turnover not exceeding EUR 50 million (Commission Recommendation 2003/361/EC)

⁹ Directive 2013/50/EU of the European Parliament and of the Council of 22 October 2013 amending Directive 2004/109/EC of the European Parliament and of the Council on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market

As a consequence, MTFs specialised in bonds, or allowing both equity and bond issuances on their platforms, can be reluctant to register as SME growth markets.

- (iii) The relative low volume of SME shares traded on MTFs is often attributed to the small size and limited free float of small issuers. However, SME growth markets are not required to impose a free float condition (on issuers seeking an admission to trading). This is a minimum amount of capital in the public's hand and that can be freely traded. In the absence of free float, liquidity can be insufficiently stimulated in the secondary market.

The Commission Delegated Regulation is based on the empowerments set out in Article 4(2) and Article 33(8) of MiFID II which grant power to the Commission to: (i) adjust the definitions laid down in Article 4(1) to market developments and (ii) specify the requirements laid down in paragraph 3 of Article 33, in particular as regards the conditions that are set for initial and ongoing admission to trading of financial instruments of issuers on SME growth markets. The Commission Delegated Regulation aims at amending Commission Delegated Regulation (EU) 2017/565.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

On 14 November 2017, the Commission services organised a technical workshop with approximately 25 securities exchange representatives, from 27 Member States. The aim of the workshop was to discuss technical provisions and potential alleviations to the regulatory framework on SME access to public markets. On 28 November 2017, the Commission services also organised a technical workshop on the same topic gathering approximately 30 representatives of issuers, investors, brokers and other financial intermediaries.

From 18 December 2017 to February 2018, the Commission services launched a public consultation on 'Building a proportionate regulatory environment to support SME listing'. The public consultation focused on three main areas: (1.) how to complement the SME growth market concept created by MiFID II; (2.) how to alleviate the burden on companies listed on SME growth markets; and (3.) how to foster the ecosystems surrounding local stock exchanges, in particular with a view to improving liquidity of shares listed on those trading venues. The Commission received 71 responses, sent by stakeholders from 18 Member States¹⁰. This public consultation raised specific questions on the non-equity issuer definition for the purpose of SME growth market, the half-yearly report obligation for SME growth market issuer and the opportunity to impose a minimum free float requirement in the EU legislation.

The Commission also had exchanges with Member States through the Expert Group of the European Securities Committee (EGESC) on 10 November 2017 and 16 April 2018 and through a meeting of the Financial Services Committee on 3 May 2018. In addition, from 3 to 15 May 2018, the Commission consulted the EGESC members on a draft Commission Delegated Regulation, in accordance with the Better Regulation principles. Seven Member States (DK, FR, NL, PL, PT, SE, UK) replied.

In line with the Better Regulation principles, the draft delegated regulation was also published on the Commission's website for four weeks from 24 May to 21 June 2018. The Commission

¹⁰ 6 public authorities (2 ministries of finance, 4 NCAs); 18 exchanges; 35 industry associations (6 for brokers, 14 for investment managers/investment banks, 4 for insurers, 3 for accounting/audit, 2 for CRAs, 4 for issuers, 1 for pension provision), 2 NGOs, 2 consultancy/law firms, 2 promotional banks, 1 academic institution; ESMA Securities Market Stakeholders Group and the Financial Services User Group. Those stakeholders come from 18 Member States: AT, BE, CZ, DE, DK, EE, EL, ES, FI, FR, HR, IE, IT, LV, NL, PL, SE, UK

received twelve contributions from public and private stakeholders¹¹. The majority of stakeholders were in favour of the modifications set out in the draft Delegated Regulation. At the same time, some stakeholders expressed concerns as regards the minimum free float requirement because such a requirement could be seen as an additional obstacle to initial public offerings by small issuers. Nevertheless, if there is no free float on admission, one could question the rationale for an issuer to consider an initial public offering on an SME Growth Market, instead of remaining a private company. The draft delegated regulation already provided the SME Growth Market operator with the flexibility to adapt the requirement to local conditions and determine the precise criterion and threshold of the free float requirement. In order to further address the concerns expressed in the public consultation, Article 78(2) (a) now sets out that the free float requirement can be expressed either as an absolute value or as a percentage of the total issued share capital. The provision further specifies that the free float requirement is only applicable to the first admission of the shares to trading (i.e. in case of an initial public offering) and not to subsequent admissions (i.e. secondary offerings).

Based on the outcome of this consultation, Article 77(2) of the draft Delegated Regulation was also modified. This Article now sets out that a non-equity issuer can be qualified as an SME under MIFID II if the *nominal* value of its debt issuances over the previous calendar year, on all trading venues across the Union, does not exceed EUR 50 million. The reference to '*debt issuances over the previous calendar year*' will avoid any confusion with the notion of *outstanding issuances*. The reference to '*nominal value*' will avoid any issue of interpretation in case of change in value of the new debt issuances over the twelve-month period.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

The Commission Delegated Regulation contains three operational provisions. First, it replaces the current definition of a non-equity issuer set out in Article 77(2) with a new definition based on an issuance size criterion. The threshold is set at EUR 50 million over a period of 12 months. This means that a non-equity issuer will be deemed to be an SME for the purpose of identifying an SME Growth Market if the nominal value of its debt issuances over the previous calendar year does not exceed EUR 50 million (excluding loans provided by a credit institution). This less restrictive definition will facilitate the registration of SME growth markets specialised in bonds and those allowing both equity and bond issuance. To avoid any risks of regulatory arbitrage, this provision also mentions that all the issuances of debt securities that could be made on all trading venues across the EU needs to be taken into account in order to determine whether an issuer exceeds or not this threshold and can qualify as an SME.

Second, the Commission Delegated Regulation modifies Article 78 (2) (g) by leaving the flexibility to SME growth market operators to impose a half yearly financial report on non-equity issuers (while keeping this obligation unchanged for equity issuers). This will establish a level playing field between non-equity issuers on SME growth market and those on regulated market that are exempted from the half yearly financial report obligation under the Transparency Directive 2004/109/EC.

¹¹ 4 securities-exchanges and one association representing securities-exchanges; 3 organisations representing issuers; 1 association representing banks; one association representing brokers and financial intermediaries; one national competent authority. Those stakeholders came from 5 Member States: BE, DE, IT, SE and UK.

Third, the Commission Delegated Regulation introduces a new point (j) in Article 78(2), thereby requiring listing rules of SME growth markets to impose a free float requirement for equity issuers when the shares are admitted to trading for the first time. Market operators or investment firms operating SME growth markets will have the flexibility to adopt the specific criterion and the threshold as regards this free float requirement. This requirement can be expressed either as a percentage of the total amount of issued share capital or as an absolute value. This would prevent SME Growth Markets from listing companies that are totally illiquid on admission.

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(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2015 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU¹, and in particular Article 4(2) and Article 33(8) thereof,

Whereas:

- (1) The Capital Markets Union initiative aims at reducing dependency on bank lending and diversifying market-based sources of financing for all smaller and medium-sized enterprises (SMEs) and in the issuance of bond and shares by SMEs on public markets. Companies established in the Union that seek to raise capital on trading venues are facing high one-off and ongoing disclosure and compliance costs which can deter them from seeking an admission to trading on Union trading venues in the first place. In addition, shares issued by SMEs on Union trading venues tend to suffer from lower levels of liquidity and higher volatility, which increases the cost of capital, making this source of funding too onerous.
- (2) Directive 2014/65/EU has created a new type of trading venues, the SME growth markets, a subgroup of Multilateral Trading Facilities ('MTFs'), in order to facilitate access to capital for SMEs and to facilitate the further development of specialist markets that aim to cater for the needs of SME issuers. Directive 2014/65/EU also anticipated that attention should be focused on how future regulation should further foster and promote the use of that market so as to make it attractive for investors, and provide a lessening of administrative burdens and further incentives for SMEs to access capital markets through SME growth markets.
- (3) To ensure the liquidity and profitability of SME growth markets, Article 33(3)(a) of Directive 2014/65/EU requires that at least 50 % of the issuers whose financial instruments are admitted to trading on an SME growth market are SMEs issuing equity and/or debt securities. Under Directive 2014/65/EU, SME equity issuers are defined as a company that had an average market capitalisation of less than EUR 200 million on the basis of the end-year quotes for the previous three calendars years. On

¹ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (OJ L 173, 12.6.2014, p. 349)

the other hand, Commission Delegated Regulation (EU) 2017/565² provides that a non-equity (debt-only) SME issuer should meet at least two of the three following conditions: (i) the number of employees (less than 250), (ii) the total balance sheet (less than EUR 43 million), and (iii) the annual net turnover (less than EUR 50 million). This requirement for a non-equity issuer to qualify as an SME has been found to be too restrictive because such issuers tend to be larger than traditional SMEs. As a result, many non-equity issuers cannot qualify as SMEs under Delegated Regulation 2017/565/EU, despite remaining relatively small. As they cannot meet the 50% threshold of issuers qualifying as SMEs, many MTFs specialised in SME debt issuances or allowing both bond and shares issuances cannot register as SME growth markets. In turn, if operators of MTFs do not make use of SME growth markets framework, issuers on those MTFs cannot benefit from the lighter regulatory requirements foreseen to foster listings and issuances on these SME growth markets. In order to enable more MTFs to register as SME growth markets, the nominal value of an issuer's debt issuances (excluding loans) over the previous calendar year should therefore be laid down as the sole criterion for qualifying non-equity issuers as SMEs for the purposes of SME growth markets. The Commission will monitor the effectiveness of the new definition of non-equity SME issuer in enabling MTFs to register as SME growth markets and its impact on market developments and investor confidence.

- (4) Delegated Regulation (EU) 2017/565 indicates that SME growth market should not have rules which impose greater burdens on issuers than those applicable to issuers on regulated markets. However, Article 78(2)(g) of Delegated Regulation (EU) 2017/565 requires issuers on SME growth markets to publish half yearly financial reports. Non-equity issuers targeting professional clients on regulated markets on the other hand are not subject to the same obligation under Directive 2004/109/EC of the European Parliament and of the Council. The production of half yearly financial reports has been shown to be a disproportionate obligation imposed on non-equity SME growth market issuers. As many MTFs with a focus on SMEs do not require half yearly financial report for non-equity issuers, such a mandatory requirement by Delegated Regulation (EU) 2017/565 appears to contribute to discouraging operators of MTFs from seeking registration as SME growth markets. The operator of a SME growth market should therefore have the flexibility to decide whether or not to impose the publication of half yearly reports on non-equity issuers.
- (5) Some SME growth market issuers have been seen to place a limited amount of their issued share capital in public hands, which makes the trading of those shares riskier for investors and has a negative impact on liquidity. This in turn acts as a disincentive for investors to invest on SME growth market listed shares. In order to ensure liquidity of shares and increase investors' confidence, SME growth market operators should therefore impose that a minimum amount of shares are placed in circulation for trading ("free-float condition") as a condition for admission to trading for the first time. SME growth market operators should however have the flexibility to set an appropriate threshold based on the particular circumstances of the market, including on whether

² Article 77(2) of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 087 31.3.2017, p. 1).

the amount should be expressed in absolute value or in percentage of the total issued share capital.

- (6) Delegated Regulation (EU) 2017/565 should therefore be amended accordingly.
- (7) A minimum period of time after the entry into force of this Regulation should be given to incumbent operators of SME growth markets, to adapt their conditions for registration. Therefore, this Regulation should apply three months after its entry into force,

HAS ADOPTED THIS REGULATION:

Article 1

Delegated Regulation (EU) 2017/565 is amended as follows:

1. in Article 77, paragraph 2 is replaced by the following:
“2. An issuer that has no equity instrument traded on any trading venue shall be deemed an SME for the purposes of Article 4(1)(13) of Directive 2014/65/EU if the nominal value of its debt issuances over the previous calendar year, on all trading venues across the Union, does not exceed EUR 50 million.”;
2. in Article 78, paragraph 2 is amended as follows:
 - (a) the following point (j) is added:
“(j) requires issuers seeking admission of their shares to trading on its venue for the first time to allocate a minimum amount of their issued shares available for trading on the MTF, in accordance with a threshold to be established by the operator of the MTF and expressed either as an absolute value or as a percentage of the total issued share capital.”;
 - (b) the following subparagraph is added:
“The operator of an MTF may exempt issuers that have no equity instruments traded on the MTF from the requirement to publish half yearly financial reports referred to in point (g) of the first subparagraph of this paragraph. Where the operator of an MTF exercises the option pursuant to the first sentence of this subparagraph, the competent authority shall not require, for the purposes of point (g) of the first subparagraph, that issuers that have no equity instruments traded on the MTF be required to publish half yearly financial reports.”.

Article 2

This Regulation shall enter into force on the day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [*Publications Office: Please insert the date -3 months after entry into force*].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 13.12.2018

*For the Commission
The President
Jean-Claude JUNCKER*