Exploring the boundaries between banking supervision and the Capital Markets Union (CMU)

3. The Industry's View

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The current situation caused by the COVID-19 pandemic has placed the Capital Markets Union ("**CMU**") under the European spotlight once again. One of the main reasons for the interest shown by economic institutions in the CMU are the benefits that its implementation will bring to the economy.

Of all the groups that have written about the CMU, we have to highlight the High Level Forum on the Capital Markets Union, which is an expert group composed of highly experienced industry executives and leading international experts and scholars established on 7 November 2020 by the EC. Its purpose is to propose targeted policy recommendations for future CMU actions, to ensure that citizens and businesses can access capital markets across the EU on equal terms and irrespective of their geographical location.

One of the areas affected by the implementation of the CMU is the Initial Public Offerings ("**IPO**"). The IPO was traditionally the instrument used by companies to obtain funds, but over the last few decades, companies have turned their backs on it as it has been replaced by other ways of obtaining funds in a more straightforward fashion. There are several factors that explain the reduction in the number of IPOs, but we would highlight the red tape and all associated costs that companies have to face while planning an IPO and once they are listed.

The change in trends mainly affects Small and Medium Enterprises ("**SMEs**"), as they are opting to grow through mergers and acquisitions, debt increase or private equity, rather than IPOs.

In the following article, we will try to summarise the current situation and the main problems with IPOs in Europe, the main recommendations proposed by the High Level Forum and the impact of these measures and, to conclude, some thoughts on the future of IPOs within the CMU framework.

1. Current situation and main problems with IPOs in Europe

As previously stated, the number of IPOs in the European Union ("**EU**") has drastically decreased over the last few years. In order to reverse this downward trend, the EU has already taken several measures, which include the modification to the SME Growth Markets and all the regulations related to them brought by the Markets in Financial Instruments Directive II ("**MiFID II**") and the Market Abuse Regulation ("**MAR**").

Both the MiFID II and the MAR have relaxed regulations for all of the SMEs listed in the SME Growth Markets, in an attempt to promote IPOs all over the EU. In this regard, the new regulations have reduced the entire administrative burden not only of being listed but also remaining listed on these markets.

Economic agents have welcomed all these changes. However, they have not been enough to reverse

the aforementioned situation regarding IPOs, as the relative numbers are not increasing.

The European Commission ("**EC**"), bearing all of this in mind, has set up several committees and expert groups in order not only to fully implement the CMU, but also to increase the number of IPOs.

2. Main recommendations proposed by the High Level Forum and their impact

These committees and expert groups have proposed several measures to tackle the full implementation of the CMU, but in this article, we will focus on those that we consider to have the greatest potential impact on the number of SMEs IPOs.

The first measure we will analyse is the proposed alleviation to MAR. This measure aims to reduce compliance costs while maintaining equal access to relevant information across market participants. This should be achieved by ensuring the principle of proportionality (i.e., the information that should be provided by a large company cannot be the same as the information provided by a SME).

The justification for this principle of proportionality lies not only on the size of the company and the quantity of information it can generate, but also the economic cost for listed companies associated with generating all of the previously required information.

In this regard, one of the changes caused by the alleviations to MAR is to insider lists. According to the High Level Forum Report, the regulation related to insider lists must be amended in order to reduce the information they should contain. By doing this, the issuers would be relieved of one of the burdens associated to being listed.

However, and as previously stated, the principle of proportionality should be preserved in order to ensure the shareholders and the investors have access to relevant information, while at the same time ensuring that SMEs are not forced to provide excessive information.

From a practical perspective, it is our understanding that all the measures aimed at reducing both the red tape and the associated costs should be welcomed by issuers and investors. Information overload is not beneficial to the investors, as this can cause distraction as well as incurring in higher costs for its analysis.

At this point, we should give a special mention to the proposed EU Single Access Point ("**ESAP**") due to its significance regarding the European regulatory institutions and access to company information. According to the High Level Forum Report, the establishment of an EU-wide digital access platform would help to make companies' public financial and non-financial information available for everyone, but on the other hand, this could result in an additional administrative burden for companies.

Furthermore, even if the establishment of the ESAP should not involve major changes in reporting regulations, some issues or reservations could arise, as the national authorities could perceive that strengthening the power of the European Securities and Markets Authority and the European Insurance and Occupational Pensions Authority infringes, or could collide with, their own powers.

The second measure we should review is the implementation of so-called dual-class shares and loyalty shares. Both breach the one-share one-vote rule, but the differences between them are vast. While dual-class shares constitute two different classes of shares with different voting rights since its constitution, loyalty shares constitute only one class of shares, but shareholders who retain the shares for a certain number of years are "rewarded" with an extra voting right. It is worth mentioning that the draft of the new Spanish Companies Act regulates loyalty shares for the first time, which has been received with certain scepticism.

By way of example, loyalty shares, as currently contemplated in the draft of the Spanish Companies Act, grant double voting rights per share to shareholders of listed companies who hold them for a minimum period of two years provided that such provision is included in the by-laws (being the approval of that inclusion subject to reinforced majorities); this two-year minimum term can be extended but not reduced. It should be noted that, except in some limited cases, the transfer of shares with double voting rights would cause these rights to be lost. In this regard, the double voting rights will be taken into account not only to establish the quorums and majorities, but also for notifying significant shareholdings and rules on takeover bids. Finally, in companies that include loyalty shares in their by-laws when applying for listing on a market, shareholders who can prove that they have held the shares for the aforementioned minimum period, will obtain double voting rights from the moment the shares are

admitted to trading. However, please note that this draft is still subject to changes until the final law is passed by the Parliament.

Given that the implementation of these kinds of shares, which should be voluntary, aims to allow owners to maintain control of their company, preventing them from being taken over by larger companies, and due to their greater popularity in European countries, we will focus on loyalty shares. However, due to the practical similarities between them, the following considerations are applicable to both.

The main point of allowing owners to maintain control of their company after an IPO is to let them focus on the company's strategy in the long term so as to not be pushed by new shareholders into focusing on short-term strategies. In this regard, we have to bear in mind that long-term investments are linked to long-term sustainability principles. Due to this relationship between long-term investments and sustainability principles, one of the measures proposed by the High Level Forum is to review the regulation of European Long-term Investment Funds in order to promote funds supporting sustainable investment objectives.

However, even supporters of loyalty shares consider that a sunset clause establishing the effectiveness period must be included with the loyalty shares provision of the by-laws of the company. Should this sunset clause not be included, the investors would be discouraged from investing in the company. The reason is that in order to obtain a controlling stake in a company, a new investor would need to make a significantly higher investment than the original shareholder would have made at the time.

Therefore, even if loyalty shares can prevent a company from being merged or acquired by a larger company or by an investment fund, this measure does not incentivise companies to make an IPO. We have to consider the implementation of loyalty shares as a protective measure, as it prevents investors from changing the company's strategy from long term to short term.

However, a company's funders or main shareholders can take several actions to prevent this from happening, like finding a white knight or entering into a shareholders' agreement with the rest of the shareholders before making an IPO, for example. In our opinion, the implementation of loyalty shares in all European markets should not be taken as a positive measure aimed at increasing the number of IPOs but at letting the controlling shareholders of a company retain their control.

The third and final measure we will analyse is the creation of a pan-European public-private IPO fund (the "**Fund**") backed by the EU, which aims to achieve two main goals. The first is to provide funds to SMEs in order to cover all the costs of making an IPO. In this regard, the research costs, which currently must be borne by the companies, would be covered by the Fund, so a greater number of SMEs would be able to attract investors' attention. The second goal is to provide funds over a long-term basis, so that companies can focus on their long-term goals. In addition, with these kind of investments, the Fund would act as an anchor investor, playing a main role in the companies' transition to public.

In our opinion, this measure is one of the easiest to effectively implement, as the EU could establish the fund using existing institutions, i.e. the European Investment Bank and the European Investment Fund.

Furthermore, this measure, alongside the creation of a pan-European index, would help to solve some of the biggest issues (e.g. the listing costs, the lack of information regarding SMEs, the loss of control of the company after an IPO, etc.) highlighted in some reports, such as those written by Josef Anton Schuster, the Federation of European Securities Exchanges, Jay R. Ritter, Andrea Signori and Silvio Vismara and the European IPO Task Force. Also, if implemented correctly, it could generate revenue not only for the companies but also for European society as a whole.

3. Conclusion

The implementation of the CMU should be a priority, not only to help to increase the number of IPOs but also to try to accelerate the recovery of the European economy. According to the main economic reports drafted in relation to the CMU, its full implementation would allow European countries not only to solve some economic issues but also to strengthen the business ecosystem.

In this regard, after reviewing the main measures we can confirm that almost all of them should have a positive effect on the European economy, increasing the number of IPOs in the years following their implementation.

However, the main point that European institutions should bear in mind is that the regulatory and corporate reality is quite different in each European country. Therefore, even if the proposed measures are positive, they can be entirely inappropriate if they are not adapted to different situations. Furthermore, the basis of some measures is correct, but the EC must develop them in order for economic agents to understand them completely.

In relation to loyalty shares, the problems related to different regulatory and corporate realities can be greater than in other areas, as the implementation of loyalty shares in technological companies could benefit the project and the original shareholders, but in other companies, this could result in some abuses. Additionally, it should be noted that in some countries, dual-class shares are banned.

In this sense, it would be necessary to determine whether the Fund would cover the costs of IPOs by investing in the companies or by granting them a loan, the structure, which companies or funds will be allowed to invest in it, etc.

In addition, regarding the pan-European index, we can confirm that this is also a good measure, but it needs further development, as it is not clear where the index will be placed, how the companies could be listed, if the listing requirements would be the same for all countries, etc.

These are just a few examples of all the questions and issues that these measures can generate and that must be solved before the CMU is fully implemented in order not to cause inequalities between European countries.

Furthermore, the implementation of these measures would trigger some challenges and complexities for financial supervisors, not only due to the strengthening of European authorities' powers, but also due to the coordination between national and supra-national public authorities. We have to keep in mind that one of the main goals of the CMU is to establish an efficient federative supervisory European model, and this would result in a reduction of national authorities' powers.

Nevertheless, and as we have mentioned throughout this article, the measures aimed at implementing the CMU effectively and improving the number of SME I