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Of: Markets Participants Consultative Panel (MPCP)
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Summary

The MPCP met on the 28 April 2010 in Paris to discuss the following issues:

- MPCP members continue to be concerned about market developments, particularly highlighting a risk of a double-dip, the return of sovereign risk, possibly serious refinancing problems in the commercial real estate sector, the amount of outstanding corporate debt and possibly rising default rates, the need for analyzing the corporate bonds market structure and the need for more investor education in light of vanishing boundaries between wholesale and retail markets. Some financial disintermediation was seen as a positive development – though possible risks in terms of financing in Central and Eastern European States and of SMEs were stressed. CESR's report on trends, risks and vulnerabilities in financial markets was received in a positive way and suggestions were made on how to develop it further. Its publication was encouraged.
- René Maatman presented CESR-FIN's plans for four work streams on corporate governance with a CESR-specific focus: a) proxy voting advice and investor engagement, b) institutional investor codes (e.g. CRAs), c) corporate governance statements in annual reports, and d) electronic communication/ value chain between company and shareholders. MPCP members welcomed the proposals.
- Concerning developments in CDS markets, MPCP members agreed that the main issue is market manipulation. The discussion evolved around the definition of a CDS (insurance contract or financial instrument) and the obligation (or not) of holding the corresponding underlying asset-, as well as the need for more standardization and transparency (including through clearing houses and organized markets).
- MPCP members discussed the opportunity for a capital market geared towards SMEs on the basis of a report produced for the French Ministry of Economy, Industry and Employment. The MPCP acknowledged the need for developing such a market segment, while highlighting some obstacles to such a project: low liquidity, possibly limited demand, corporate governance issues within SMEs, incentives to financial intermediaries, threshold of market capitalization for IPO and coverage fees, as well as the risk of EU-wide definitions vs. the need to account for country-specific characteristics.

The next MPCP meeting is scheduled as a joint CESR-MPCP meeting in the afternoon of the 14th September 2010.



Agenda item 1 | Update on market developments

MPCP members discussed market developments on the basis of CERS's report on trends, risks and vulnerabilities in financial markets, which was received in a positive way. A range of suggestions were made for the further development of the report.

During the discussion the following risks and issues were singled out:

- risk of a double-dip, with spill-over effects from the U.S. (though signs of a sound recovery in terms of job creation were recognized for the U.S. and Germany) and a potential for a panic on sovereign debt,
- return of sovereign risk,
- growing corporate indebtedness with possible defaults at a 3-year horizon and a flight to quality,
- the need to assess the quality of market structure in corporate bonds,
- troubled assets persisting in balance sheets of part of the banking sector,
- short-term funding needs may still be pressing in some banks,
- risk stemming from the commercial real estate sector as over the next years many contracts will need to be refinanced,
- the risk of front-running in high-frequency trading and the need to obtain more information on this practice,
- need for investor education in light of vanishing boundaries between wholesale and retail markets,
- risks of economic and political instability for democracies.

Concerning the financial crisis in Greece, the possibility of debt restructuring was highlighted as one workable solution.

It was recognized that securitisation markets would need to recover, and the potential for a quick self-healing process through a "back-to-basics" strategy was stressed in this respect. More transparency and simplification of ABS structuring was highlighted as desirable so as to assure investors. In the short-run, the ECB is seen as continuing to play a role in terms of collateral recognition.

Financial disintermediation was perceived as a trend to continue since the cost of borrowing is likely to be higher because of more stringent regulation. It was also seen as a broadly positive development, although some limitations exist: in certain jurisdictions, in particular Central and Eastern European countries with less developed financial markets, banks would continue to play a key role; the same is true when it comes to SME financing (the need for developing financial markets geared towards SMEs in the medium term was, however, recognized). Moreover, the currently successful recourse to debt issuance was seen as posing some risk in the medium run should companies or banks become too indebted. Some members stressed the risk of higher defaults once refinancing waves return. Finally, IPOs as a direct source of financing were mentioned by one member as being structurally in difficulties in the last decade and not only in the past two years. However, should the cost of borrowing effectively rise in the near future, IPOs could become popular again.

MPCP members stressed that investor protection would need to be given more emphasis going forward, particularly in the light of vanishing boundaries between the wholesale and the retail sector. UCITS were mentioned as one example where these boundaries have decreased since hedge fund strategies, for instance, can now be easily marketed to retail investors. Additionally, banks selling retail products are not necessarily subject to comparable disclosure requirements for bank products/structured products as is the case for securities.

Agenda item 2 | CESR-Pol proposals for work on corporate governance

René Maatman presented CESR-FIN's proposals for four work streams on corporate governance:



- a) Proxy voting advice:
A reduced number of institutional investors typically play key role; there is generally low accountability; there are conflicts of interest; there is a need for increased transparency;
- b) Institutional investor codes (e.g. CRAs):
There is a need for more consistency/ harmonisation across the EU;
- c) Corporate governance statements in annual reports:
Reviews by Members show a lot of differences in this area;
- d) Electronic communication/ value chain between company and shareholders:
It does not seem always ensured that investors are reached when it comes to the use of electronic communications.

MPCP members welcomed the proposals and stressed the role of blockholders which sometimes align on government positions against minority shareholders, the difficult borderline between corporate law and securities law, the risk of empty voting if the current low level of shareholder activism (20%) would change. A proposal was made to give the issuer the right to know the identity of the shareholder or to make this identity transparent. A risk was perceived that the financial crisis could lead to reduce the rights of shareholders. Finally, investor engagement, particularly with retail investors, was mentioned by members as one of the key issues still to be tackled in most jurisdictions. There was some support for the securities regulators further defining their specific interests notwithstanding the difficult borderline between securities and company law.

Agenda item 3 | Developments in CDS markets

MPCP members discussed where the focus of regulatory action should be concentrated. For some members, the question of defining a credit default swap (CDS), as an insurance contract on a given debt or as a financial instrument is essential to the obligation (or not) from the buyer to hold the corresponding underlying security.

For other members, the discussion should be focused on improving the transparency and standardization of the CDS market. One member highlighted that the CDS market underwent significant industry-driven changes over the last 12 months (e.g. more standardization, extensive use of CCP, less backlogs) and suggested the industry should seek to achieve further results in those areas. In particular, these key points should be: 1) price and volume dissemination (transparency); 2) robust and accessible central clearing to all OTC derivatives; 3) higher product processing and legal standardization (and not only for CDS); 4) trading in organized markets for standardized products; 5) ensuring robust risk management through better bilateral collateralization agreements (including operational frameworks) and 6) improving operational risk management through the whole process. These points received broad agreement by members,

It was, however, noted that there are limits in this respect (e.g. need for bespoke CDS contracts) and that one should not lose out of sight that financial markets need to be innovative (the CDS market is a relative young market which is key for risk management and debt hedging). One member noted that CCPs must be properly supervised, well-capitalized and equipped with appropriate agreements on collateral so as to be robust.

Members agreed that there is a risk of market manipulation that should be properly dealt with – the framework (i.e. the Market Abuse Directive) is already in place for the equity market and should be extended to others. One member mentioned the need to acknowledge the important impact of CDS trading on debt spreads (as noted in the case of Greece),

Agenda item 4 | Capital markets geared towards SMEs



MPCP members discussed the opportunity for a capital market geared towards SMEs on the basis of a report produced for the French Ministry of Economy, Industry and Employment. The MPCP acknowledged the need for developing such a market segment, while highlighting possible obstacles to such a project: limited demand from investors, the lack of liquidity, corporate governance issues within SMEs, possible lack of interest in growth from SMEs, incentives to financial intermediaries (who work on reasonably high fees), the threshold of market capitalization for IPOs, as well as the risk of EU-specific definitions (e.g. medium caps) vs. need to account for country-specific characteristics. One member noted the need to combine lighter regulatory obligations with investor protection, a balance difficult to achieve. Besides, this balance should be envisaged for companies of any size.

Some members stressed that the development of the SME segment would rather require an intervention on the incentives to the demand of SME securities by institutional investors (specialized funds, tax incentives) and a more active role of financial intermediaries in assisting the potential issuers to enter capital markets.

Agenda item 6 | Any other business

The Panel agreed to hold its next meeting on 14 September 2010 as a joint meeting with CESR-MPCP meeting.



Annex 1

Excerpt from the report “An EU-Listing Small Business Act – Establishing a proportionate regulatory and financial environment for Small- and Medium sized Issuers Listed in Europe (SMILEs)”

“A CRA International study¹, commissioned by the European Commission, has measured the impact of the EU Directives on the Initial Public Offering (IPO) market. One of the conclusions of the study is that the decrease of activity on the IPO market is not purely cyclical. Clearly, initial and ongoing requirements for issuers have impacted the decision-making process to float a company as well as the way exchanges have structured their listing and trading facilities. Furthermore, statistics show a constant decrease in the number of listed companies on EU regulated markets. This can be explained by the decreasing number of new entrants but, more significantly, by the fact that listed companies decide to de-list and go private. This trend mainly affects Small and Medium-sized Issuers Listed in Europe”

Definition of SMILEs and Policy

Recommendation #1: Create a legal EU definition of “Small and Medium-sized Issuers Listed in Europe” (SMILEs)

A definition should be included in the Prospectus Directive or the Transparency Directive, to which other directives could refer. Small and Medium-sized Issuers Listed in Europe (SMILEs) would be:

- At the initial public offering (IPO), companies for which the transaction value is of less than € 75 million. Member States may decide to set a lower threshold for those companies for which they are the Home Member State.
- AND, if admitted to trading, companies for which the market capitalisation is less than 35% of the average market capitalisation on the regulated market(s) of the Home Member State of the issuer.

If a SMILE crosses the latter threshold during 2 subsequent years, it will cease to be considered as a SMILE after a 12-month transition period.

Thresholds should relate to year-end market capitalisation during the year of the initial listing and, subsequently, to the average of the previous 2 years.

The definition of SMILEs could be inserted into Article 2 (4) and referred to in Article 7 (2) (e) of the Prospectus Directive or included in the implementing Regulation.

The extent to which third country issuers offering securities or seeking a listing in the EU could be considered as SMILEs should be specified by way of a delegated act.

Recommendation #2: Implement the “Think Small First” principle in any legislation and in the day-to-day supervision

- The European Commission should implement the “Think Small First” principle when proposing new legislation in the area of financial services, capital markets and issuers.
- New legislative proposals for listed companies should include a cost-benefit analysis and demonstrate whether a proportionate regime for SMILEs is relevant or not.
- Specific resources should be devoted to the promotion of the “Think Small First” principle within the EU Commission Internal Market DG, within the future European Securities Markets Authority and special units for SMILEs should be created within national competent authorities.

Proportionate offering and listing requirements

Recommendation #3: Facilitate private placements by raising the thresholds triggering the obligation to produce a formal prospectus

The securities offering threshold, below which a formal prospectus approved by a competent authority is not required, should be raised to €5 or 10 million.

Recommendation #4: Provide more meaningful information to investors by creating specific schedules for SMILEs in the Prospectus Regulation

- The financial information requirements to be included in proportionate schedules for shares, debt and derivatives securities, for the exclusive use of SMILEs, should be integrated in the Prospectus Regulation 809/2004 by way of a delegated act (Level 2).
- To ensure legal predictability for issuers, the schedules for SMILEs should be drafted in detail and, to the maximum extent possible, include all information requirements. Article 3 of the above mentioned Regulation should then be fully respected.
- To ensure that the prospectus becomes a useful document for investors and focuses on key information necessary for investment decisions, prospectuses for SMILEs should not exceed 50 pages and its editing format should be harmonized by a technical standard of the CESR/ESMA (Level 3).

Recommendation #5: Determine proportionate information requirements for a SMILE prospectus

- Audited historical financial information, and all other information referring to the period covered by the historical financial information, should cover the latest 2 years (or such shorter period that the SMILE has been in operation)
- Disclosures should be limited to the latest Financial Statements



- Specific materiality threshold should be introduced and information required only if it has a significant impact on the SMILE

- The Share and Debt or Derivatives Securities Registration Document should be streamlined in some sections (3, 6, 9, 10, 11, 14 and 20) and be more specific on other sections, which are of particular relevance for investors in SMILEs (section 4) (see Annex 2).

Recommendation #6: Allow more flexibility to raise capital

SMILEs could be exempted from the obligation to publish a Prospectus for shares representing, over the previous 12 months, less than 15% of the number of shares of the same class already admitted to trading on the same regulated market.

Proportionate on-going requirements

Recommendation #7: Develop a single and fully harmonized format for the publication of Annual Reports

Subject to a more detailed harmonisation of the definition of the content of Annual Reports, at least for SMILEs, the disclosure of Annual Reports under Article 4 of the Transparency Directive should be of maximum harmonisation.

Recommendation #8: Allow a three-month deadline for the publication of Half-Yearly Financial Reports

Option 1: For SMILEs, the Half-Yearly Financial Reports required under Article 5 of the Transparency Directive should be published within 3 months after the end of the period covered (instead of 2 months).

Option 2: If the Half-Yearly Financial Report has been audited or reviewed by an external auditor, the Half-Yearly Report required under Article 5 of the Transparency Directive should be published within 3 months instead of 2 months after the end of the period covered.

Recommendation #9: Enable SMILEs to progressively publish Quarterly Interim Management Statements

The publication of Quarterly Interim Management Statements required under the Article 6 of the Transparency Directive should become compulsory from SMILEs only after three years of admission to trading on a regulated market. During this initial three-year period, listed SMILEs should be free to publish Quarterly Interim Management Statements on a voluntary basis.

Recommendation #10: Create a proportionate IFRS regime for the publication of Financial Statements – IFRS for SMEs

Reconsider the need to publish all currently required disclosures resulting from the full IFRS and allow SMILEs to waive this requirement.

Following careful consideration and consultation by the Commission and CESR/ESMA, SMILEs admitted to trading on a regulated market could be given the possibility to use IFRS for SMEs to present their Financial Statements.

In order for IFRS for SMEs to be fully applicable to SMILEs, some additional financial information requirements, not currently contemplated, would need to be added.

Recommendation #11: Allow reference to proportionate national Corporate Governance Codes

SMILEs should be authorised to disclose under the Prospectus Directive the way in which they comply with Corporate Governance rules by referring to proportionate Corporate Governance Codes.

Recommendation #12: Scale Internal Controls Standards for SMILEs

Member States should consider reviewing their standards and guidelines related to internal controls so as to scale requirements and adapt them to the size of SMILEs.

Market Integrity

Recommendation #13: Waive the obligation to maintain an insiders' list

Provide SMILEs with the possibility of waiving the obligation to draw up a list of insiders under the condition that the persons likely to have access to insider information are duly informed of their legal and regulatory duties and aware of the sanctions attached to the misuse or improper circulation of such information.

Recommendation #14: Provide more meaningful information to the market on transaction by SMILEs' Managers

Create in Article 6 of the implementing Regulation of the MAD a specific regime by which SMILEs Managers should notify transactions on shares, or the financial instruments linked to shares, issued by the company they manage, representing at the end of the calendar year more than 0.02% of the market capitalisation of the company (as computed at the end of the previous calendar year).

Recommendation #15: Favour liquidity provision for SMILEs' shares traded on EU regulated markets

Liquidity providers, acting with appropriate "Chinese Walls" and by virtue of an agreement with the relevant issuer, should be able to provide their services across the EU on legitimate grounds.

The Market Abuse Directive as well as its implementing Regulation should explicitly recognize this activity as an "accepted market practice". In particular Article 3 of the Regulation on buy back programmes (n°2273/2003) should allow that the purpose of buy back programme is also to facilitate the activity of liquidity providers.



Investor's interest for SMILEs

Recommendation #16: Create an EU passport for private equity funds

Directly or through the managers of the funds, create an EU passport for EU domiciled private equity funds with adapted functioning rules. The current proposed AIFM Directive could be used for this purpose.

Recommendation #17: Create a specific UCITS dedicated to investment in SMILEs

The European Commission should study the possibility of creating within the UCITS Directive a new category of UCITS dedicated to investments in SMILEs, to which specific rules would apply and also defining the conditions for EU domicile private equity funds to benefit from an EU passport and be marketed to retail investor.

Recommendation #18: Ensure that capital and liquidity requirements under the Solvency II Directive do not damage equity investment, in particular in SMILEs

- When considering the implementing measures of the Solvency II Directive, the EU Commission, Member States and the European Parliament should be able to measure the overall impact of these prudential requirements on the efficient allocation of capital within the whole EU economy.

- In particular, lower capital requirements than those currently envisaged should be considered for equity investments.

- Capital requirements could be even lower for investments in SMILEs' equities as a consequence of the very low percentage they represent in insurers' portfolios.

“Think Small – Act Big”

Recommendation #19: Preserve the flexibility and attractiveness of exchange-regulated (alternative) markets

- SMILEs quoted on exchange-regulated markets should benefit from all the modifications to the Prospectus Directive; and in particular the possibility to publish a Proportionate Prospectus.

- The extension of provisions of other EU Directives or Regulations to exchange-regulated markets should be left to the discretion of Member States and/or national competent authorities or the market operators themselves.

- The harmonisation of rule books on the cross border activity of exchange-regulated markets should not be done by means of EU law but rather left to market forces.

Recommendation #20: Establish a joint EU trading platform for SMILEs

- Under the auspices of the European Investment Bank (EIB), the operators of EU regulated markets, active intermediaries/brokers and long term institutional investors should work together to create an EU Multilateral Trading Platform for all SMILEs listed on their regulated markets.

- Listing functions and revenues would remain at the level of each EU regulated markets and trading revenues would be shared by the joint owners of the platform.

- Supervision and enforcement of SMILEs listings and ongoing obligations would continue to be exercised by the Home competent authorities in accordance with the relevant Directives.

- Through a legal ability for competent authorities to delegate powers to the European Securities Markets Authority (ESMA) or by way of a direct entrustment introduced in the MiFID, this joint trading platform should be licensed and supervised directly by the ESMA.