

- **A holistic approach to revitalizing the European Scale up ecosystem**

The challenge of scaling up innovative SMEs in Europe must not be addressed in isolation. It is a strategic economic imperative that requires a coherent, global and systemic approach. Fragmented or siloed initiatives are ill-suited to a problem that stems from deeply interlinked issues ranging from regulatory disincentives to market structure shortcomings.

MIFID II unbundling rules have for instance drastically reduced research coverage for smaller listed companies, undermining their visibility to investors, which was predicted by market participants. We face a similar threat, with the upcoming RIS and national cost centric fund benchmarks, which prioritize costs over performance and long-term value creation, making SME focused investments less attractive to both retail and institutional investors. These developments collectively erode the economic fabric that supports innovation and competitiveness.

To reverse this trend, we need to rebuild a thriving, competitive financing ecosystem for SMEs, one that supports them throughout their life cycle, from early-stage growth to maturity and beyond.

Crucially, the scale up agenda must address both listed and unlisted financing channels. Private equity funds typically hold investments for five to six years. Without sufficient large-scale funds capable of providing follow-on funding of exits, there is a growing risk that successful European companies are sold off to non-EU buyers, particularly from the US and UK.

Finally, the gap between private and public markets deserves targeted attention. Emerging “private market infrastructures” – such as the Deutsche Börse model or the UK’s PISCES initiative – could provide much-needed secondary liquidity for private equity assets. These structures would support fund growth while reducing the current reliance on traditional IPO or trade-sale exits.

- **Convergence of listed and non-listed assets**

UCITS : In order to create inflows of investments for SMEs, UCITS should be allowed to invest in funds in their 10% limit under Article 50(2)(a) of the UCITS Directive (known as the 10% other values/trash ratio¹). The current legal interpretation allowing (up to 10%) only for direct exposure to assets like private equity is detrimental in practice. Allowing indirect exposure through specialized funds (like ELTIFs, private equity funds and other AIFs investing in eligible assets to the 10% ratio) would open again¹ the possibility for UCITS to finance smaller companies and

¹ On 20 November 2012, ESMA published the Opinion 2012/721 on the interpretation of Article 50(2)(a) of the UCITS Directive, which deals with investments in transferable securities or money market instruments “other than”

it can be very significant given the size of the UCITS market (7 224 Bn€ for the equity funds, and 2 268 Bn€ for the multi-asset funds).

ELTIF : AFG believes in the convergence of listed and unlisted assets, like the ELTIF funds. They are long-term funds, invested in majority in non-listed assets, and allow redemption by being partially open-ended funds. It diversifies the portfolio of retail investors, actively channeling savings into SME financing. By being diversified, they are less risky than purely venture capital funds, making them more suitable or appropriate for a large part of the retail investors.

- **A need to boost IPO**

The stock market must regain its ability to attract companies and no longer be a default solution (which is the case today, at least in France). Several avenues are being explored to solve this problem: IPO bonuses – like the one initiated in Italy, facilitating access for individuals, and improving access to information during IPOs.

- **Increasing funds size**

The size of investments made by funds is representative of their overall size. Therefore, funds of all sizes are needed to finance companies of all sizes. To attract institutional investors, the smallest funds will struggle to attract either fund of funds or institutional investors because of the combination of minimum amounts those will invest (5 million, 10 million), and by the control ratio – as those investors avoid owning more than 10 / 15% of any fund.

Fund size is important for unlisted companies, but also for listed ones. In the listed market, funds must be large enough to invest in major IPOs and have the liquidity to do so. These strategies can only be operated as actively managed funds. In this sense, there should be avoided any regulation or incentive that will amplify the already existing appetite toward passive funds (like RIS – or in France the Benchmark ACPR).

- **Investment is a limited resource**

The introduction of labels or incentive schemes – which can prove very effective (Tibi in France for investment in Tech companies) always involves constant amounts. These initiatives enable part of the savings to be reallocated, but do not increase the amount of savings available – which is something to be aware of.

Hence, if we want to finance scale-ups without reducing the amount of financing available to smaller companies, increasing the size of funds must not be done at

those meeting the eligibility requirements. This opinion, we think, wrongly interpreted that the derogation mentioned in Article 50(2)(a) does not extend to units or shares of collective investment undertakings (i.e. non-eligible funds) and required portfolio adjustments by 31 December 2013. This meant selling all funds invested by UCITS under this derogation, namely private equity funds, among others.

the expense of smaller funds. To achieve this, there is an urgent need to channel savings into financing the European economy in order to make them more productive.

- **Need of incentive to direct savings towards the economy**

There is a need for a competitive, attractive, and efficient financial market in the EU. The legal framework must find some stability and must stop the ever-increasing complexity. The constant changes are also a strong deterrent factor for all financial participants.

There is no silver bullet but several initiatives to unlock the potential to direct more funding into the economy with a double approach:

1. "To increase the overall size of the pie" – i.e. how can we better involve retail investors in financial markets (objectives of the RIS, SIA, PEPP/IORP projects, and financial literacy initiatives)?

2. "To focus on where savings ultimately end up" – i.e. how can we channel household savings towards productive European investments (objective of the "Finance Europe" label) and long-term investments (such as ELTIFs)?

Also, it is important:

- **to prevent the introduction of new regulations that will discourage investment in European SMEs, like RIS.** As they stand, the current draft proposal shows a strong bias in favour of low-cost products. This is unfavorable and even detrimental to products with higher cost due to certain specific characteristics. This is particularly the case for small and mid-cap equity funds, which may be more expensive than large-cap equity funds, given for instance the cost of research (let's remind the disastrous effects that the MIF unbundling research reform has had, in spite of all voices that had raised to warn against it). These products ultimately risk being dereferenced (which is already the case in France, given the national benchmark on funds that has been put in place), which is detrimental to investors (who are deprived of opportunities) and to the financing of the economy, innovation, and transitions.
- **Avoid the creation of a new product that will not fit into the different jurisdictions.** Past experiences have proved that it is better to be label oriented.

There are already interesting initiatives which could help direct those savings toward the European economy.

- **Label Finance Europe:** The purpose of this label is strongly supported by AFG's members. This initiative should rely on clear criteria, incentivizing EU long term investments.
- **Retirement savings / auto-enrolment** – rather than creating new products, ease the implementation of good practices in existing ones such as promoting investments in EU companies and gathering more savers around a long-term approach.
- **Tax incentive to own equity** – like the French PEA (Stock Investment Plan),
- **Beware of “simple” products**, which will only channel even more flows into passively managed index funds, that largely track indices drifted towards non-EU companies.
- **To scale up companies, the EU will need financial and non-financial reforms**

Numerous scale-up companies are not yet profitable, which makes them vulnerable. Therefore, it should be envisaged to:

- **Allow for accelerated procedures to solve litigation** between shareholders, as lengthy litigations could stale the company, leading to its bankruptcy. Even 1 year for a settlement is too long for this type of firm that is “burning cash”.
- **Simplify their governance, as often it may be complex and costly.**
- **Facilitate the build up / commercial growth of companies in the EU market.** As of now, the EU innovative companies face difficulties in trying to grow rapidly in the EU markets are multiple and fragmented, listing rules are different from one market to the other, there are administrative and registration complexities that can translate into entry barriers, etc. Therefore, they grow significantly less rapidly than their US counterparts.
- **Clarify the possibility of redemption for shareholders** – especially for Biotech or other sensitive areas (are there criteria, clear rules, ...?). The capacity to allow for redemption is considered at the investment stage. Helping to clarify these aspects would help channeling more money into these vehicles as it fosters a higher degree of legal certainty the investors seek. In addition, EU should prevent allowing for legislation and incentives that discourage investing in the EU (such as RIS).

- **Public procurement is also a tool which must be better used in the EU.**
EU companies' growth would be greatly helped if sustained by internal demand from the EU.

AFG unites asset management professionals in France, encompassing funds investing in listed and non-listed assets. In 2024, we created the SME 2030 Initiative, in order to gather asset managers specialised in SMEs, to make their input matter in a more organized way on regulatory texts and to share and spread the best market practices.