Two proposals to direct Italian savings towards listed SMEs and expand the size and liquidity of the Italian stock market

This document has been drafted by Massimo Fuggetta, Chairman and CIO of Bayes Investments, a company that manages the Made in Italy Fund, an open-ended mutual fund dedicated to listed Italian SMEs, and was signed by the persons listed at the end.

The ultimate goal is to create the best conditions for the listing of Italian SMEs, their access to Italian and foreign capital and their growth and internationalisation in support of the PNRR.

Executive Summary

- SMEs are a driver of growth, innovation and internationalisation of the economy. Their listing on the stock market plays an important role for an advanced economic system thanks to the multiplier effect deriving from the injection of Italian and foreign institutional capital.

- The Italian stock market is modest in size compared to the country's economy and the major European and world stock markets.

- To increase the size of the market, there is a need to encourage new companies to list. But it is also necessary to promote the participation of individual and institutional investors.

- Two strategic interventions are proposed in this regard:

    1. PIRs incentivise Italian savings to invest in the domestic economy by channelling resources to companies, but have so far played an insufficient role, which should therefore be strengthened. We propose to raise the minimum share of investment in listed SMEs in Ordinary PIRs, currently 3.5%, to a significantly higher level, and to direct Alternative PIRs, in which the minimum share invested in SMEs is 70%, to focus more on listed SMEs.

    2. Pension savings have so far played an even more modest role that, following the example of France, should be decisively enhanced. It is proposed that a state-participated PIR fund of funds be created – along the lines of similar vehicles managed by Cassa Depositi e Prestiti and the European Investment Fund for investments in Private Equity and Venture Capital – that would be able to attract Italian and foreign institutional investors, and encourage participation in it by social security institutions.

Introduction

As highlighted in the Green Paper on The Competitiveness of Italian Financial Markets in Support of Growth and in the OECD Capital Market Review of Italy 2020 – Creating Growth Opportunities for

Italian Companies and Savers, the Italian stock market is small compared to the country's economy and to the major European and world stock markets.

A large and efficient stock market is an important driver of growth, innovation and internationalisation in an advanced economic system, resulting from the multiplier effect generated by the injection of Italian and foreign institutional capital to support the PNRR.

Thanks to the commitment of Borsa Italiana for SMEs, combined with that of other market players and the presence of tax incentives for listing, at the end of 2022 there were 414 listed companies in Italy, with a total capitalisation of €662 billion, or 34% of GDP. Of these companies, 334 were SMEs, defined as companies with capitalisation below 1 billion, of which 144 were listed on the main market EXM (Euronext Milan, Ex-MTA) and 190 on EGM (Euronext Growth Milan, Ex-AIM Italy). The total capitalisation of SMEs was about €45 billion[1], of which €10.6 billion was in EGM companies.

By comparison, however, on Euronext Paris there are more than 800 listed companies – twice as many as on Euronext Milan – with a total capitalisation of more than €3 trillion, more than four times that of Italy and equal to more than 100% of French GDP. Of these, more than 600 are SMEs, with a total capitalisation of 82 billion.

France is the leader in asset management in the Eurozone, with more than €4,800 billion under management, more than 700 asset management companies, of which more than 450 are independent companies and more than 200 have been created in the last five years. The industry employs 85,000 people, of which 26,000 work in asset management companies.[2] There are currently around 80 funds specialising in domestic SMEs in France, managing total assets of over 6 billion.

The Green Paper calls for

> a structural 'change of pace' in the relationship between companies and the capital market; on the one hand by removing regulatory and operational constraints on companies' access to the market, and on the other hand by introducing measures to stimulate, on both the demand and supply side, the channelling of investments to companies via the markets (p. 2).

SMEs are the companies most in need of the change of pace called for in the Green Paper. The wide gap between France and Italy will not begin to close until this aspiration is translated into ambitious and effective practical measures aimed at increasing the participation of individual and institutional investors in the Italian stock market.

Individual investors: the PIR

The most important initiative aimed at stimulating Italian savers to invest in SMEs was the introduction of Individual Savings Plans (PIR) in 2017. Although it has gone through alternating phases, it has been a successful initiative: according to the latest PIR Observatory compiled by Assogestioni, at the end of 2022 the PIRs promoted by the association's member companies were worth €18.9 billion, of which €17.4 billion in Ordinary PIRs and €1.5 billion in Alternative PIRs. This is an appreciable sum: 1.9% of the assets promoted in open-ended funds and closed-end real estate funds, amounting to 989 billion, but almost double the total invested in Italian Equity Funds (8.2 billion) and Italian Bond Funds (1.6 billion).

[1] Source: Factset
[2] Data at end 2021

On balance, however, it is clear that Ordinary PIR have responded only minimally to the objective for which they were created: to channel Italians' savings towards SMEs. Contrary to what is commonly imagined, barely 5% of the value of Ordinary PIRs is invested in securities of listed SMEs – slightly above the minimum level of 3.5% set by law.

In response to this shortcoming, Alternative PIRs were created in late 2020, for which the minimum investment in SMEs was raised from 3.5% to 70%. But the value of Alternative PIRs is still low compared to that of Ordinary PIRs. In addition, the PIR Observatory estimates that, out of the 1.5 billion value[3] , 0.9 billion is in cash/commitments and feeders, while only 0.5 billion is actually invested in stocks, bonds and other 'vehicles'. Of these, no less than 82% is invested in unlisted securities, while the percentage invested in listed SMEs is only 15%, amounting to just 75 million – 30 million on EXM and 45 million on EGM. This is just 5% of the total invested in Alternative PIRs, far from the 70% required by law.

It must therefore be acknowledged that even Alternative PIRs have largely failed to meet the objective of increasing Italian savers' participation in the capital of listed SMEs. While Ordinary PIRs are predominantly invested in securities of medium-large companies, Alternative PIRs are predominantly invested in unlisted securities.

The result is that, out of a total of 18.9 billion invested in PIRs, only 5%, or 0.9 billion, is invested in listed SMEs – barely 2% of their capitalisation. Paradoxically, the companies that should be the main beneficiaries of the PIRs are those that benefit the least.

<u>Institutional investors: pension funds and social security funds</u>

Another important potential source of financing for SMEs is pension savings. As shown in the latest COVIP Report and in the COVIP Report on the investment policies of pension funds, at the end of 2021 total assets invested by the Italian social security system amounted to €321 billion, of which €213 billion in pension funds and €108 billion in social security funds.

Of these, 72 billion were equity investments: 51 billion in pension funds, or 29% of the total (see Table 1.21 of the Report)[4] , and 21 billion in social security funds, or 19% of the total (see Table 4 of the Report).

Looking at domestic investments (see Section 3 of the Report), these totalled 77 billion: 40 billion in pension funds, or 23% of the total, and 37 billion in social security funds, or 34% of the total. But of these, 42 billion (or 54%) were invested in government and other debt securities (81% for pension funds and 25% for social security funds) and 21 billion (or 28%) in real estate, including real estate UCITS (8% for pension funds and 50% for social security funds). Only the remaining 14 billion – 18% of domestic investments and 5% of total assets – were invested in equities, OICVM units and units in other security OICR: 6 billion in pension funds and 8 billion in social security funds. Of these – which the COVIP Report defines as 'the financial resources destined for Italian companies' (p. 23) – 4 billion were invested in bond instruments, 5 billion in equity instruments, and 5 billion in securities UCITS.

[3] To this sum we must add the funds of companies that are not members of Assogestioni, first and foremost Azimut, which, according to the latest PIR Monitor prepared by Equita SIM, managed EUR 731 million in Alternative PIRs (third quarter 2022 data). Adding these funds together, the value of Alternative PIRs rises to 2.5 billion.

[4] The total net assets of pension funds shown in Table 13 are 176 billion lire, corresponding to investments directly attributable to supplementary pension schemes.

It is therefore clear that, as the Report itself comments below, 'When compared to the total financial liabilities of Italian companies, the contribution made by pension savings remains modest, at around 0.4%'. A similar comment is made in the Report (p. 49):

> Excluding Italian government bonds, the contribution that the complementary forms system makes to the Italian economy is limited, even in international comparison. The reference to diversified market benchmarks on an international scale in which the weight assigned to Italy is marginal, given the small number of Italian listed companies and the limited development, at a national level, of private equity and debt markets, are still valid as possible braking factors.

This reproduces, in extreme form, the situation of PIRs. Retirement savings, already underinvested in the Italian stock market, are not invested at all in listed SMEs.

The two proposals

1. Strengthening the RIPs

For PIRs to play the important role for which they were created, it is necessary that Ordinary PIRs are directed to invest a significantly higher share in listed SMEs.

The minimum quota, currently at 3.5%, should be raised to a significantly higher level, to be agreed with the trade associations.

Alternative PIRs, in which the minimum share is 70%, should **focus more on listed SMEs**.

2. Targeting retirement savings

In order for pension savings to make an appropriate contribution to the strengthening of the Italian stock market, pension funds and social security funds should be directed to adopt a consistent *Home Country Bias* – an allocation to domestic equities significantly greater than that of benchmarks, allocating an appropriate portion to SMEs. This investment could conveniently be in place of the currently prevailing domestic assets: government bonds for pension funds and real estate for social security funds, allowing access, among other things, to the same tax benefits of PIRs (see Circular 19/E 2021 of the Agenzia delle Entrate).

As stated in the Green Paper (p. 34) and the OECD Report (p. 16, 21, 45), the most suitable form of investment in listed SMEs is that of a **fund of funds.** Such a fund would invest in a selected portfolio of PIR-compliant equity funds – both in existing ones and in new listed funds and investment vehicles that would thus be stimulated to emerge and grow – allocating a portion of the total to each, so as to ensure greater liquidity and diversification.

A fund of funds of, say, €3 billion would amount to a modest 1% of the total assets of funds. The fund could be created within Cassa Depositi e Prestiti and/or the European Investment Fund, along the lines of similar initiatives in the field of Private Equity and Venture Capital.

The fund would have three important positive effects:

1. It would provide resources for the financing and growth of SMEs that have had the ability to complete the listing process and the merit of opening their capital to public investment.

2. It would create an important natural source of demand, encouraging the listing of new companies and expanding the size, value and importance of the Italian stock market.

3. It would facilitate the creation and growth of investment funds focused on the Italian stock market, increasing their liquidity and efficiency, and developing research, knowledge and analytical capabilities.

Not least, the fund would allow the social security system to invest in Italian companies with the greatest growth potential, to the benefit of members and the Country.

The proposals contained in this document are endorsed by (in alphabetical order):

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