QUOTED COMPANIES ALLIANCE

FUTURE OF THE UK MARKET STRUCTURE FOR QUOTED COMPANIES

Addressing critical issues to ensure that the UK's capital markets are vibrant, efficient and continue to generate growth and jobs.

Position Paper – July 2017

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Quoted companies make a substantial contribution to the economy. In 2013, AIM companies contributed £14.7bn to UK GDP and directly supported more than 430,000 jobs.[i]

Nonetheless, the number of companies accessing public markets has declined steadily over the past ten years. There has been a 31% fall in the total number of companies listed on the London Stock Exchange and a 41% decline in the number of AIM companies.[ii] This is a worrying trend which needs to be reversed if we want to keep the economic growth generated by these companies.

There are several critical issues which need to be addressed to ensure that the UK's capital markets are vibrant, efficient and continue to generate growth and jobs. We see the impending departure of the UK from the European Union as an exceptional opportunity to initiate action and secure a thriving market environment for the future.

KEY MESSAGES

1. CREATE STABILITY AND FLEXIBILITY IN UK CAPITAL MARKETS

→ **Protect economic stability** during the negotiations and avoid actions which may cause major disruption to the markets. Uncertainty will inhibit investment decisions which will have a negative, longer-term effect on the economy.

→ **Simplify the tax system** and make it more certain to promote long-term investment. The overly complex tax system does not sufficiently differentiate between small and mid-size companies and large companies, and is a barrier, in particular, for growth companies looking to scale up.

→ Give companies **sufficient transition time** to adjust to any new measures resulting from the UK's departure from the EU. This will help minimise negative effects of the exit, spread out costs and facilitate a smooth transition.

→ **Preserve and strengthen AIM and NEX Exchange** as exchange regulated markets with a flexible regulatory framework.

→ **Explore alternative vehicles for public company investment** to boost the attractiveness of capital markets and encourage companies to seek public equity.

2. RECALIBRATE EU-DRIVEN LEGISLATION TO SUIT UK MARKET STANDARDS

→ **Review specific pieces of EU-driven legislation**, such as the Market Abuse Regulation and MiFID II, which have been particularly burdensome for growth companies and make them suited for UK markets.

→ Establish a **dual mandate of competition and productivity** for the FCA. This will make the FCA weigh the cost of additional regulation against any potential adverse economic effect.

→ Adopt a **"think small first"** policy to protect growth companies from rules aimed at large businesses.

3. AGREE ON RECIPROCAL MARKET ACCESS AND MOVEMENT OF WORKERS BETWEEN UK AND EU

→ **Keep the easy flow of capital, goods and services** between the UK and EU to facilitate investment and entrepreneurship opportunities.

→ **High tariffs would jeopardise** the future of companies whose business models depend on a tariff-free environment. Any changes in tariffs should be done gradually to allow companies to absorb the costs over time.

→ Guarantee **easy access to skilled labour from EU member states without prohibitive levies** so that UK companies can remain competitive and protect the future growth and development of their business.

I. BACKGROUND

This position paper sets out our vision for the future of the UK market structure from the point of view of small and mid-sized quoted companies. We put forward market structure principles as well as detailed recommendations which aim to ensure that the UK's capital markets are attractive for both companies and investors alike.

Public equity markets are suffering from a downward trend. The past decade has shown a number of companies choosing another source of funding, delisting or delaying their decision to come to the market. In 1999, the average age of companies going public was four years whereas in 2014 it was 11 years.[iii]

This is not down to one single factor but is the consequence of a number of different reasons such as the increasingly complex regulatory framework, taxation, share voting structures and the rising cost of the overall listing process.

The public equity markets are a substantial contributor to the UK economy and therefore the underlying reasons for the decline need to be tackled. The growth company sector which contributed £14.7bn to UK GDP is on par with the automotive industry which contributed £11.5bn to the GDP and the pharmaceutical sector which contributed £13.3bn in the same year.[iv] Whereas the latter are considered as the Government's key industrial sectors the growth markets are rarely featured at the forefront of any Government policy.

In the coming years the UK will need to harness the power of all of its sectors in case there is a lull in economic growth as it extricates itself from the European Single Market and the Customs Union. It is therefore of critical importance that the economic contribution of small and mid-size quoted companies is recognised and the markets are adjusted to create an environment where they are able to unleash their true potential.

II. MARKET STRUCTURE PRINCIPLES FOR SMALL AND MID-SIZE QUOTED COMPANIES

This section sets out the market structure principles which are needed to create effective and attractive public equity markets for small and mid-sized quoted companies.

→ **Easily accessible primary markets** with clear listing rules and a streamlined approval process.
→ **Effective and attractive secondary markets** with proportionate standards and enforcement measures.
→ **Market operation**: different types of **markets for different** types of **companies.**
→ **Efficient trading market** with **optimised liquidity** and well-functioning **clearing and settlement.**
→ **Well-prepared issuers** who understand equity markets.
→ **Availability of investment** to be encouraged by **education, investment research** and benchmarks.
→ **Balanced taxation and other incentives** to attract issuers and investors to public equity markets.
→ A variety of **advisers with diverse experience** to assist with market rules and processes.

1. Easy access to the primary market

Barriers to entry to the primary market should be low for companies. Rules and requirements should be made more transparent with clear guidelines and advice. There needs to be:

- Clear listing/admission rules. The UK listing authority (UKLA) should work with exchanges to build effective and unambiguous listing rule guidance for both the senior and junior markets.
- Clear prospectus requirements. The current prospectus rules should be reassessed and adjusted to be more appropriate for the framework of the UK financial markets once the UK leaves the EU.

- A clear and streamlined approval process by the market operator and regulator to speed up the listing process and reduce the costs of seeking advice.

2. Effective secondary markets

Effective secondary markets allow companies further funding to help them scale up. To encourage companies to seek further funding rounds, the secondary market needs to be a compelling place which functions effectively. It will need to have:

- An appropriate regime for market abuse management (e.g. insider lists, market soundings);
- Appropriate reporting, accounting and transparency standards;
- A good supply of investment research, surveys and other market information;
- An effective corporate governance regime; well applied, monitored and enforced;
- Access to UK and international investors for further money raisings;
- Continued access for smaller companies to investors;
- A good set of benchmarks across markets and sectors.

3. Market operation

There need to be markets dedicated to smaller companies; the idea of one-size fits all does not produce an optimum outcome. To consolidate this:

- The regulator should be required to take the interests of smaller quoted companies into account. Currently any cost benefit analysis is conducted on the stock market as a whole, leading to the regulatory concerns surrounding the large companies to have a disproportionate and anti-growth effect on the smaller quoted companies;
- The small cap markets should be marketed effectively both domestically and internationally;
- Each market should have a clear identity and a vision of the companies it wishes to attract;
- The regulator needs to have productivity and growth as part of its objective. This would ensure that the cost of additional regulation is weighed against any potential adverse economic effect that might result.

4. Efficient trading market

The level of efficiency of the trading market plays an important role in attracting companies to the market. Therefore, attention should be paid to having:

- Trading systems which optimise liquidity with a choice of trading systems; and
- A clearing and settlement regime which recognises the specific needs of smaller companies.

5. Well-prepared issuers

The markets require well-prepared issuers who understand equity markets. There should be:

- A good supply of pre-IPO companies;
- A wide range of companies on the market: different sizes, sectors and origins;
- Effective education and training (ELITE, QCA events; guides) to raise knowledge of equity markets;
- The ability to raise primary and secondary finance and list on other European markets efficiently.

6. Availability of investment

The small cap sector is less liquid and higher risk but can yield greater benefits than the large cap sector. However, its nature dictates that it may not always be the first choice for investors. To encourage investment in smaller companies there should be:

- A solvency regime that allows/encourages investment in equity, particularly smaller companies;
- Conduct of business and KYC rules that encourage private investor investment in smaller companies;
- Benchmarks that reflect the breadth of smaller companies;
- Access to investment research;
- Effective education of private investors on the small cap market;

- Reduction in the obstacles to the provision of prospective financial information to the market.

7. Taxation and other incentives

Equity markets contribute to economic growth and job creation. It is therefore important to create incentives to attract issuers and investors alike. This can be done by:

- Equalising tax treatment with other forms of financing;
- Maintaining the stamp duty abolition, AIM into ISAs, Investor Relief and IHT Relief;
- Expansion of IHT Relief so that specialised IHT funds can spread the risk for investors;
- Expansion of EIS and VCT regimes (previously prevented by state aid rules) particularly to provide follow-on funding to avoid a funding gap as new companies go for growth and scale-up;
- Continuing to motivate employees through share schemes and other incentives such as by expanding the enterprise management incentive (EMI) regime to enable more companies to qualify.

8. Variety of advisers with diverse experience

Markets of all sizes need advisers to guide both issuers and investors on the specific rules and processes. This is particularly salient for the small cap markets where the companies are young. Therefore, there needs to be a good variety of advisory firms with diverse experience including:

- Accountants;
- Lawyers;
- Nominated advisers and;
- Brokers.

III. MARKET STRUCTURE REFORM PROPOSALS FOR SMALL AND MID-SIZE QUOTED COMPANIES

Over the years the QCA and its expert groups have worked on a number of initiatives to promote the interests of growing businesses and to encourage more companies to look for long-term capital through growth markets such as AIM and NEX Exchange. Our proposals aim to break down barriers and challenge existing preconceptions about the market structure so that the potential of growth companies can be harnessed for the benefit of the wider economy.

CREATE STABILITY AND FLEXIBILITY IN UK CAPITAL MARKETS

a) Preserve and enhance UK growth markets including AIM and NEX Exchange

The growth markets are important UK assets. Governments have invested greatly in such markets through IHT Relief, Stamp Duty and ISA changes. These incentives recognise that AIM and other growth markets are key to the future success of the UK economy in helping growing companies to access capital, innovate, create new jobs and build wealth for the economy.

One of the key ingredients of these markets is the flexible regulatory structure. This has enabled these markets to avoid much of the disproportionate legal and other burdens levied on smaller companies on the regulated markets. The cost of capital for AIM and NEX Exchange-listed companies is therefore relatively lower than that of companies on the Main Market of the London Stock Exchange.

The EU's recognition of growth markets as SME Growth markets should be mirrored in the UK so that these markets can continue to have laws and rules that are fit for purpose rather than to be burdened with laws and rules designed for the largest, global companies and banks on the Main Market.

b) Simplify the tax system

Tax incentives have led to greater funding for many medium sized UK quoted businesses and the overall effect has boosted UK employment, domestic growth and additional tax take over the last two decades. Nevertheless, the tax system continues to be complex and burdensome for companies. We believe there to be several ways in which to encourage investment in growth companies and to make listing on a public equity market more attractive.

i. Equalise tax treatment with other forms of financing

There is a distinct need to address the preferential treatment of debt over equity as a source of finance for growing companies. Currently, companies can claim a tax deduction for costs incurred in raising debt finance, but not for equity finance. This has resulted in a distorted tax system.

Yet, OECD research has highlighted the advantages equity has over debt: "The empirical results reported above suggest that in most OECD countries more debt is typically associated with slower growth while more stock market financing generates a positive growth effect. Furthermore, recent OECD work[v] (Ahrend and Goujard, 2012) found that corporate tax systems which favour debt over equity are associated with a higher share of debt in external financing, thereby increasing financial crisis risks. The economic literature and earlier OECD work identified that the debt bias in corporate taxation generates costly economic distortions (De Mooij, 2012; Devereux et al., 2013; OECD, 2007). These findings all underline the growth benefits of reducing the debt bias in corporate taxation. Effective average tax rates on equity finance generally exceed those on debt finance, primarily because interest expenses are cost-deductible."[vi]

Similarly, a review of the European listings regime has indicated that allowing equity costs to be tax deductible would promote long-term stability and help smaller companies secure long-term capital to sustain their growth.

The Government should level the playing field between debt and equity by providing tax relief on all costs relating to the issue of new shares as part of a public offering (both IPO and secondary fundraisings). Enabling smaller, growth companies to fully harness the potential of capital markets would widen the provision of long-term capital and establish a sustainable funding pipeline for growth companies.

ii. Broaden the scope of Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) rules

Creating a tax system that encourages long-term investment by potential high-growth companies is essential in increasing the number of successful high-growth businesses in the private sector. We believe that the Government should broaden the scope of the EIS and VCT rules, so that all growing companies, regardless of their age, can fully leverage these schemes. This would allow more high-growth businesses to raise the finance they need to flourish. We have seen examples of smaller quoted growth companies that have sought investment, only to find they are ineligible to take advantage of EIS and VCT, due to the time limits imposed.

Some conditions specified in the EIS/VCT rules can also be very difficult for small and mid-size quoted companies to meet – particularly those regarding new products, geographical markets and skilled employees. Refining these requirements would add more clarity and ease administrative burdens for growth companies.

Equally, the new rules have placed an additional burden on many advance assurance applications, which has led to increased waiting time for responses. This in turn has placed further constraints on companies seeking to raise financing for their businesses. The Government should increase the Small Companies Enterprise Centre's resources to reduce complexity and bring down timescales, to enable the service to allow small, growing companies to take full advantage of these venture capital schemes.

iii. Relax Company Share Option Plan (CSOP) requirements

The current CSOP legislation does not meet modern remuneration practices. The administrative burdens deter many smaller companies from offering such an arrangement. The Government should introduce more flexibility for CSOPs by allowing the exercise price to be at a discount or at nil cost, removing the three year holding period before options can be exercised with income tax relief and increasing the current limit of £30,000 to a new limit of a figure between £30,000 and £250,000 for CSOP options. Implementing these measures would incentivise the provision of long-term finance and encourage employee share ownership.

c) Explore alternative vehicles for public company investment

The Government should look to challenge the "one share, one vote" model of corporate ownership. Many entrepreneurs are often reluctant to "give up control too early" when they join a public market. One potential solution could be to allow new IPO companies with suitable stakeholder representation to list variable voting shares on the stock market, subject to them following an appropriate corporate governance code. This could encourage entrepreneurs to enlist their company on a public market by enabling them to maintain control of the company they have founded. It could also open new opportunities for them to attract new sources of patient capital that can then be used to grow and develop the company. The successes of Google and Facebook should encourage the Government to explore alternative vehicles for public company investment. Their experience indicates that investors are not necessarily deterred from investing in companies that have variable voting rights.

d) Improve communication between companies and shareholders to enhance trust

To help improve the way in which companies and shareholders communicate with each other three fields should be added to companies' share registers: the name of the "voting decision maker", the number of shares they can vote, and an email address for companies to use to advise that new shareholder information has been published on their website. This will address the issue of confused ownership chains. A nominee holding may have more than one voting decision maker depending on the number of underlying holdings. Alternatively, the nominee holder could commit to suitable alternative mechanisms to facilitate shareholder engagement.

Furthermore, companies should no longer be required to send information to shareholders by post. Instead all information should be put on a website and an email sent to the address on the register to advise voting decision makers of this new information. There may need to be an opt-in provision for shareholders without email to be sent a hard copy to advise them that this information has been published.

The Stewardship Code should be expanded to cover investor contact with the Chair. Since the Chair is the person responsible for corporate governance, investors cannot be serious about engaging on corporate governance unless they have spent time with the Chair.

e) Protect economic stability

Companies work best when there is a known environment within which to operate. Removing regulations and laws to free up resources and capital, to energise the economy is always welcome.

As far as possible government should avoid sweeping additional burdens and ensure that, in addition to its own departments, agencies under its influence such as FCA and FRC are cautioned to make graduated changes and as few of them as possible.

f) Allow for sufficient transition time for businesses

Cliff-edge changes to legislation and regulations lead to significant one-off costs for smaller quoted companies. These are incurred at the same time as other, larger companies. Often the resources required are not available for smaller companies as they are being consumed by their larger counterparts.

In any event, such changes often require significant management time to understand the effect and to implement these issues. The economy would benefit if smaller quoted companies were given a minimum of three years to move towards any major, new regulatory or legislative regime. This should be a maximum period so that companies choosing to adopt a change could do so at any time within the prescribed period. This would allow companies to plan changes so as to reduce disruption and ultimately to ensure better quality compliance. This would lower the cost of capital and improve corporate performance.

ADJUST LEGISLATION AND SUPERVISION TO SUIT UK MARKET STANDARDS

a) Review EU-driven legislation

We encourage HM Treasury to conduct a comprehensive review of key financial services regulation to make it more suited to the UK market structure. We have highlighted here the regulations that we believe the Government should review as soon as possible once the UK is no longer a member of the EU. In any revision or new policy instrument the Government should adopt a policy of thinking small first to avoid putting disproportionate burden on smaller companies.

Carry out a complete overhaul of the Market Abuse Regulation (MAR)

The Market Abuse Regulation, which came into force in July 2016, has created several issues for market participants. Below, we pinpoint a number of concerns that are most relevant to small and mid-size quoted companies:

Requirement to create and maintain insider lists – The delay in the implementation of MiFID II means that prior to its implementation, the requirement to keep an insider list in accordance with the provisions of Article 18 of MAR is too onerous and burdensome for small and mid-sized quoted companies given the level of resources available to such companies and the purpose for which insider lists are kept.

ESMA's proposal that the list of information to be provided in the notification of the delay should include place of birth, personal phone numbers and email addresses is especially onerous, as such details are not required to be kept by organisations in the UK. Obtaining and maintaining records of individual's home addresses, dates of birth and national identification numbers (passport or NI numbers) would be administratively and unnecessarily burdensome and disproportionate given the purpose of an insider list. There are also potential data protection issues as a result of this requirement. However, maintaining information regarding name, position within the issuer (or adviser), work address and work email address should not be onerous for small and mid-size quoted companies, as they raise the degree of professionalism of the board. The insider list rules should be retained but guidelines in relation to information required should mandate only as much information as is necessary to identify the individual.

Exemption to the requirement to create and maintain insider lists – Although the SME Growth Market exemption allows for a more proportionate regime to apply, there will, in practice, still be a need for such issuers to have sufficient systems and procedures in place to produce an insider list if requested by the competent authority. This may lead to the requirement for such issuers to establish costly internal systems and / or processes, which increases administrative burdens. This exemption should specifically identify AIM companies (rather than referring to SME Growth Markets), taking into account the level of resources available to small and mid-sized quoted companies and how this will affect them as a result.

Delayed disclosures of inside information – The proposed ESMA guidelines remain overly restrictive in relation to legitimate interests for delaying disclosure of information. The removal of "*impending developments that could be jeopardised by premature disclosure*" from the list of illustrative examples is unhelpful to issuers. Despite the rationale given by ESMA for the deletion that the provision is too generic, we believe that the aforementioned statement is helpful as a statement of principle. Specifically removing it from the existing guidance could cause issuers to assume that impending developments are incapable of constituting a legitimate interest justifying delayed disclosure.

The existing CESR Guidance contains a statement (at paragraph 2.7) that, "*Issuers should consider the particular circumstances of their case when deciding whether they can delay disclosure*". This guideline is helpful in that it emphasises the need to avoid a "one-size-fits-all" approach.

We have already urged ESMA to include as much clarity as possible on the delayed disclosure provisions, for example clarifying the meaning of the terms "*materially different*" and "*signals*" in 3.4(2) (a) and 3.(2)(c) of the draft guidelines.

In PS17/2, published in February 2017, the FCA set out its final rules in relation to delayed disclosure of inside information. The FCA added a new DTR 2.5.1B which requires issuers to be aware of the ESMA Guidelines and in particular, the non-exhaustive list of legitimate interests of issuers to delay disclosure and situations in which delayed disclosure is likely to mislead the public. Further guidance on this was provided by the amendment to DTR 2.5.4G in which some examples of situations which the FCA does not think paragraph 5(1)(8)(a) of the ESMA MAR delayed disclosure guidelines does not envisage will result in delayed disclosure were provided.

The UK should consider implementing its own guidelines or including detail (such as a non-exhaustive list of legitimate interests) in the DTR itself. More clarity should be given as to what will constitute a legitimate interest in delaying disclosure. It should refer to the expansive view on right to delay announcements taken in *Hannam v FCA*. It should also consider whether a company should be required to keep a record of reasons why disclosure has been delayed.

Disclosure of PDMR transactions – There should be clear guidance on what types of transaction do and do not need to be disclosed, as well as the scope of the relevant provisions in the context of different types of transaction. We support the aggregation of transactions as a means of making the disclosure exercise as simple as possible. This should be continued and be on a same day basis with no netting, with only the highest and lowest prices (not the weighted average) disclosed. The timeframe of the executions would not be disclosed.

Dealings by PDMRs during a closed period – ESMA guidelines stipulate that where the expiration date of assigned options, warrants or convertible bonds under an employee's scheme is in the closed period, the exercising of the options, warrants or the conversion of the convertible bond and the selling of the shares acquired by exercising these rights in the closing window is allowed provided the PDMR notifies the issuer of its choice to exercise at least four months before the expiration date. We consider this period to be too long as it requires the PDMR to make an investment decision significantly in advance of the instrument's expiration date; we recommend a two-month period. We also recommend further clarification on the circumstances where a PDMR may deal in a closed period.

Market soundings – We believe that it is neither appropriate nor proportionate for provisions or procedures which a regulated firm is required to have in any event (for example under MiFID) to apply to issuers. Issuers that are not themselves regulated by a competent authority would not have company recorded mobiles and landlines. The technical standard should be rewritten so it is sufficient for the regulated firm that is the disclosing market participant acting for the issuer to keep the records and soundings lists for a market sounding in which the issuer participates.

Record keeping requirements should be simplified and guidance should be given (either in MAR itself or any guidelines which the UK may implement) in relation to the order of steps to be taken when making a disclosure.

ESMA's proposed requirement to specifically note discrepancies of opinion between Disclosing Market Participants (DMPs) and Market Sounding Recipients (MSRs) are onerous for small and mid-size quoted companies. This should be recorded as a subsidiary matter in the MSR's assessment of whether it has received inside information.

Interaction between MAR and the AIM Rules regarding inside information and price sensitive information – Where there is confusion over whether information amounts to inside information (under Article 17 of MAR) and/or price sensitive information (under AIM Rule 11), an AIM company's nominated adviser will be required to consult both the FCA and the AIM Regulation of the London Stock Exchange simultaneously. However, dual consultations are unnecessarily complicated; AIM companies should be able to consult with one body only. We suggest that the definitions "inside information" and "price sensitive information" are harmonised and contain objective tests only. This should be based on the result of *Hannam v FCA*, which clarified the reasonable investor test and consider working this into the definition.

PDMRs – PDMRs are required to notify their dependent children of their obligations regardless of their age. This rule should be modified in order to take into account issues of legal capacity, literacy and comprehension for infants. Parents should take responsibility for children under 16.

Inside information – It can be extremely difficult to decide whether or not information should be treated as inside information for the purposes of Article 7. Due to the element of subjectivity in the current test, further clarity to Article 7 would be welcomed. This could be based on the clarification of the '*reasonable investor*' test in *Hannam v FCA*.

PDMR and PCA[vii] transactions – Firms are obliged to publicise managers' dealings within three working days of the date of the trade but the persons caught by the regime also have the same three-day period to inform their firms (Art 19(1) and (3)). Many issuers have adopted a provision in their share dealing code requiring PDMRs to notify them of dealings within one or two business days to give the issuer sufficient time to notify the FCA and disclose to the market. This requirement should be amended so that PDMRs are required to notify issuers within one to two working days to ensure issuer has sufficient time to meet three working day deadline. Alternatively, the issuer deadline could be extended to four working days.

These issues provide an overview of some of the problems with MAR. The level of resources and the quantity of legal advice that is required to ensure that companies comply with these new rules is proving to be too onerous and burdensome for small and mid-sized quoted companies. We urge the Government to carry out a comprehensive review of the regulation as soon as possible to alleviate the cost and administrative burden of the regulation on small and mid-size quoted companies.

At the minimum, we would encourage the FCA to take immediate steps to issue clear guidance to companies to help them interpret the regulatory obligations correctly.

Revise the prospectus rules to suit the needs of UK capital markets

We have welcomed many aspects of the new prospectus rules and believe they represent an improvement on the current regime. Nonetheless, after the UK's departure from the European Union the Government should make further adjustments to the rules, so that the regime is more appropriate for the needs of the UK capital markets.

Raising the threshold for which companies are obliged to produce a prospectus from eight million euro to at least £20m. Increasing the persons limit from 150 to at least 200; making the summary and risk factors regime less prescriptive in terms of number of pages and number of risks (and/or their materiality); the summary and the risk factors should be a matter of judgement. These would be welcome first steps in encouraging smaller, growth companies to seek funding from public capital markets.

Whereas the Prospectus Regulation establishes a lighter "EU Growth Prospectus" we would recommend that, for non-regulated markets, the UK uses the investor protection measures enshrined in the UK's financial promotion regime and elsewhere to permit (proportionate) prospectuses to be issued in connection with public offers on certain FCA approved markets, such as AIM. These prospectuses do not need to be subject to the scrutiny and approval of the UKLA, as the UK's existing financial services legislation and regulatory regime provides sufficient protection for investors to ensure that these prospectuses are sufficiently informative, accurate and not misleading.

We recommend retaining the general disclosure obligation contained in the "informed assessment" test for listing particulars enshrined in Section 80 FSMA 2000 – also found in Regulation 9 of the former Public Offers of Securities Regulations 1995 (SI 1995/No.1537).

Moreover, prospectuses for public offers could be required to be filed at Companies House or other public registry, so that there is some degree of public scrutiny. This approach would avoid the two-tier market approach implicit in the EU's proposals where companies on an EU Growth Market would be subject to differing disclosure regimes by virtue of their size and/or market capitalisation.

We would support retaining proportionate prospectuses for secondary issuances and the greater use of incorporation by reference having regard to issuers' disclosure obligations.

The new Prospectus Regulation is expected to apply from July 2019. Since the new rules are an improvement on the current Directive we would encourage the Government to have a prospective enactment of legislation in the Great Repeal Bill which would make the Prospectus Regulation applicable in the UK regardless of it no longer being an EU member state.

Modify the Markets in Financial Instruments Directive (MiFID II) to boost investment research

The Directive on Markets in Financial Instruments will apply from 3 January 2018. Small and mid-size quoted companies are mainly affected by the impending changes to investment research.

The MiFID research rules apply when a firm produces or arranges for the production of investment research that is intended to be disseminated to clients of the firm or to the public. This does not include where a firm distributes investment research exclusively to members of its group.

A firm must ensure the implementation of all of the MiFID measures for managing conflicts of interest in relation to the financial analysts involved in the production of investment research and other relevant persons (including corporate finance personnel and persons involved in sales and trading activities on behalf of clients or the firm) whose responsibilities or business interests may conflict with the interests of the persons to whom the investment research is disseminated.

Further, a financial analyst should not become involved in activities other than the preparation of investment research where such involvement is inconsistent with the maintenance of the financial analyst's objectivity, e.g. participating in investment banking activities, participating in pitches for new business or road shows.

Independent investment research on SMEs has experienced a significant drop since 2007 when the original MiFID was introduced. The work product has become a marketing communication and, in the UK due to financial promotion rules, cannot be made generally available. This has created a considerable informational imbalance between the professional investment community and other investors. The economics of SMEs dictate that sponsorship of coverage is the only realistic means by which the market can be provided with quality investment research.

However, investment managers may only receive research when paid for either by a client agreed research payment account, a company specifically having paid for research to be written about itself and then distributed as a marketing communication or from an investment manager's own resources. The challenge is that the administrative burden and cost of maintaining compliance with such rules is high for small company brokers and small company investment managers in comparison to the benefits.

These rules are likely to further reduce the production and distribution of research reducing transparency and market liquidity in small quoted companies. We therefore believe there to be a strong case for reforming the rules around investment research to facilitate the wider distribution of the research that most SMEs rely on.

Make the Central Securities Depositaries Regulation (CSDR) proportionate for smaller companies

In an attempt to minimise risk in settlement the EU has increased the theoretical minimum liquidity required to access equity capital markets, increased market volatility (creating an environment rife for abuse) and crystallised significant losses for a range of investors. This is damaging for everyone, but specifically causes significant harm to smaller companies either who have or wish to raise equity capital. The rules were designed for liquid stocks but do not adequately address smaller companies.

Firstly, the QCA's members tend to be issuers of low liquidity instruments. Their markets tend to demand market maker support to maintain constant pricing to allow valuation.

Market makers have an obligation to buy and sell. This obligation provides a guaranteed divestment opportunity (to an extent). The ability to divest is a key part of willingness to invest. The obligation to sell on demand means market makers may be obliged to short sell, something for which they are provided an explicit exemption due to the Short Selling Regulation (SSR), due to the important role market makers play.

In liquid markets a short can easily be covered by either accessing the liquid market and purchasing shares, or by borrowing them. For less liquid shares neither of these avenues are generally available as the security and institutional holders are either few in number or, where they do exist, unwilling to lend something that cannot be easily returned.

With CSDR, people who do not settle trades at the agreed time will face daily fines until the trade is settled. These fines pass down any chains of settlement so that only the initial failing part pays up. This will always be the market maker (despite their exemption), as naked short selling will be against the SSR for most people. Liquidity providers are thus fined for providing liquidity in periods where demand outstrips supply (i.e. fining them for performing the specific purpose for which they exist).

Secondly, should the trade fail to settle by a certain extended date, the trade will be arbitrarily cancelled and the difference between the original price and the current price paid to the purchaser. This creates an opportunity to ramp the market in less liquid securities via an abusive short squeeze. For example, if a dishonest investor tries to buy shares in a security that is tightly held by the entrepreneur that created the business, they might enter into a trade to buy shares and either expect or recognise that the trade has not or will not settle. The dishonest investor can then buy more shares or at least express such an interest. This demand pressure on market makers will lead them to have to increase prices to try and locate sellers so that they can cover their short positions to prevent large losses. The continued pressure combined with a lack of settlement means the prices will rocket as desperate market makers try and cap their losses.

At the end of the period the difference between the first trade and the 'reference' price will see huge profits to the dishonest abuser, and huge losses to the market maker. Even in rising markets this loss situation will arise for purely legitimate reasons (i.e. people in smaller companies tend to all be buyers or sellers.)

These two elements combine in such a way that market making becomes uneconomical. 1) Smaller market makers cannot profitably trade: The logical inference is that they will deregister from a security / securities. This will reduce liquidity in the market and concentrate on a few significant firms. This is bad for price formation and contradicts the desire to create a healthy environment for quoted/market maker driven securities. It provides security for all knowing the price is formed from a diverse range of participants. 2) No market maker can profitably trade: All market makers withdraw, which will lead to little/no liquidity being available, as there is no two-way price. Holdings cannot be valued or worse become valueless.

There is also an issue regarding settlement performance (i.e. settling trades on time via CREST): market makers falling below 15% of the required performance level are kicked off the system. The problem is that almost all these market makers falling below the required level are small-cap market makers. This indicates a regulatory problem with settlement and should be reformed.

Finally, standardising price increments will have a detrimental effect on UK growth markets. These limits on the amount that can be made from UK trades clearly have an impact on the potential profitability of market makers and banks.

The UK’s departure from the EU could provide an opportunity to significantly restrain/reform this EU-driven regulation – at least for the small-cap market – in order to drive equity capital markets. UK regulators need to be aware that smaller companies cannot be treated on the same basis as large companies. As demonstrated above the new rules for central securities depositories put a disproportionate burden on smaller companies – an issue which needs to be addressed.

Money Laundering Directive (4MLD): beneficial ownership aspects

The Fourth Money Laundering Directive (4MLD) is to be implemented in national law by 26 June 2017. Since 6 April 2016, most UK companies and LLPs and societates europeae have had to maintain a register of people with significant control (PSC register). DTR 5 companies are currently exempt from the requirement to maintain a PSC register, but the text of 4MLD only exempts companies listed on "regulated markets” and not companies admitted to trading on "prescribed markets". 4MLD's implementation could therefore effectively bring in an obligation for AIM and NEX Exchange companies to maintain a PSC register, in addition to compliance with DTR 5.

We are concerned about the additional obligations for AIM and NEX Exchange companies and believe that it would be disproportionate for small and mid-size quoted companies on multilateral trading facilities with a primary market function (such as AIM and NEX Exchange) to have to obtain and hold information on their beneficial owners, as these are publicly quoted companies subject to the same ongoing disclosure requirements and transparency rules as their counterparts on regulated markets. Placing the obligation on these companies would result in unnecessary added costs and compliance burdens for no benefit.

If the implementation of 4MLD results in AIM and NEX Exchange companies having to maintain a PSC register, the Government should consider reinstating the exemption for DTR 5 compliant companies to help alleviate the burden on small and mid-size quoted companies.

b) Mitigate the changes brought by the Great Repeal Bill

We understand that the Government's current intention is that this Bill (to become an Act at or before the time of the UK's withdrawal from the EU) will convert existing EU law into domestic law "wherever practical and sensible". This will preserve the EU laws that are directly applicable, such as EU regulations, and all laws implementing EU obligations, such as under EU directives. It will also provide for changes to be made to address deficiencies in the preserved law after withdrawal.

We support the principles of the Great Repeal Bill but we include here our suggestions, not only as to where the deficiencies are in preserving EU laws but also where improvements may be made. Our comments are confined to English company law.

Small and mid-size quoted companies have become used to the English company law regime and its requirements. Current company law does not, for the most part, present small and mid-size quoted companies with regulatory burdens. If, under the Great Repeal Bill, English company law is to retain the same laws derived from EU membership and the provisions of those EU regulations are treated as part of English company law, that should not in general cause undue disruption to small and mid-size quoted companies.

The following main areas would however need to be addressed in the short to medium term:

i. Cross-border mergers **-** This regime assumes that the UK is an EU member state. Strictly it is not part of the Companies Act 2006 as it is contained in the Companies (Cross Border Mergers) Regulations 2007 (SI 2007/2974). Upon and following EU withdrawal, an English company would no longer be able to be involved in such a cross-border merger. As it is fairly rare for English companies to use this mechanism, we doubt that this change would be regarded as a significant disadvantage. But the consequences should be addressed in legal provisions, perhaps by the repeal of those regulations.

ii. European Companies **-** For the UK to keep these types of company registered in the UK would be inconsistent with the UK no longer being an EU member state. There are not many of them registered in the UK and this point may not actually be relevant to small and mid-size quoted companies anyway. But there will need to be provision for their change of status on EU withdrawal.

iii. Definitions throughout the Companies Act 2006 and other EU law references **-** This area is of real significance to all companies, not just small and mid-size quoted ones: there are numerous references in the Act to EU directives and some references to EU regulations; for example in these definitions:

- Section 1173: "Audit Regulation"; "credit institution"; "financial institution"; "regulated market"; "transferable securities";
- Section 494A: "Audit Directive"; "public interest company";
- Section 519A: meaning of "public interest company", "non-public interest company";
- Section 539 "MiFID investment firm";
- Section 833A: distributions by insurance companies authorised under the Solvency II Directive.

And in provisions in relation to the following:

- Accounts: IFRS, or EU adopted IFRS;
- Registration details, e.g. in register of directors, corporate directors, distinguishing "an EEA company to which the First Company Law Directive (68/151/EEC) applies".

There will need to be provision to address these questions:

(a) Will those references to EU law be frozen as at the withdrawal date?
(b) Will they, as now, follow the EU law changes?
(c) Will the effect be different depending on the particular reference?

We can see advantages and disadvantages for small and mid-size quoted companies whichever solution is adopted.

Small and mid-size quoted companies will need certainty as to what the law is and will want minimal change. Our preference is that, for the short to medium term at least, those EU law references should be interpreted so that the law changes with the changes to the underlying references. However, the underlying EU law changes should be monitored in case those references cease to be beneficial to UK companies.

c) Establish a dual mandate of competition and productivity for the FCA

The FCA should have a dual objective: oversee the good operation of financial markets and deliver ongoing growth and productivity improvement in the UK. This would put the FCA in a position where it would have to weigh the cost of additional regulation against any potential adverse economic effect that might result. This new objective might underline the importance of addressing the underdeveloped portion of institutional capital allocated to growth companies, especially smaller quoted companies.

The FCA should be required to take the specific interests of smaller quoted companies into account. Currently any cost benefit analysis is conducted on the stock market as a whole, leading to the regulatory concerns surrounding the large companies to have a disproportionate and anti-growth effect on the smaller quoted companies.

We would also encourage the FCA to establish a fast-track team for listing growth companies on the regulated market for both IPOs and secondary fund raisings. This would incentivise companies to continue to scale up and transition onto the regulated market.

d) Ease regulatory burden on advisors and brokers

AIM rules have been increasingly toughened since 2009 and then applied vigorously by AIM Regulation. This has resulted in the balance between who is responsible or who is sanctioned by AIM Regulation if there is no compliance with the AIM Rules, tilting away from the companies towards advisors. This has resulted in advisors being over-regulated. Banks have ceased working on AIM deals due to the excessive regulatory burdens. Therefore easing the regulatory burden on advisors and brokers would increase the attraction for working with AIM companies.

e) Think small first

We strongly encourage the Government to prioritise the needs of smaller companies when considering any new policy instruments. Measures deemed suitable for the largest companies are often ill-suited for small, growing companies and put disproportionate requirements on these companies creating unnecessary barriers to growth.

AGREE ON RECIPROCAL MARKET ACCESS AND MOVEMENT OF WORKERS

a) Keep free flow of capital, goods and services between the UK and EU

Companies that successfully manage to scale up and grow have a significant positive impact on the economy. At the start of 2016, small and mid-size companies accounted for three fifths of the employment and almost half of turnover in the UK private sector[viii]. Research shows that there is a potential of creating £225bn additional GVA and 150,000 net jobs by 2034 by supporting growth companies[ix]. These numbers demonstrate the vital role that smaller companies play in the UK economy.

Over the years growth businesses have benefited from and become accustomed to a tariff-free environment of capital, goods and services. If tariffs were suddenly introduced and barriers put up it would put the future growth of these companies in jeopardy and disincentivise growth companies to continue to export to markets in the EU. It is therefore paramount that post-EU Britain continues to have reciprocal market access with low tariffs and low barriers to the flow of capital, goods and services to incentivise companies to scale up and grow.

b) Easy access to skilled labour from EU member states

Today's business environment is highly competitive and companies need to have the ability to hire the skills they need to help grow their business. Curtailing or ending the freedom of movement of workers between the UK and EU will create problems for companies in the UK who rely on being able to tap into the EU-wide labour force when seeking specific skills. Restricting the freedom of movement might ultimately compromise investment decisions of the companies affected by the restrictions. It is therefore vital for the development and competitiveness of companies to have continued access to the skills and talent they need.

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[i] http://www.londonstockexchange.com/companies-and-advisors/aim/publications/documents/gteconomicimpactofaim2015.pdf
[ii] http://www.londonstockexchange.com/statistics/historic/main-market/main-market.htm; http://www.londonstockexchange.com/statistics/historic/aim/aim.htm
[iii] http://www.mckinsey.com/industries/high-tech/our-insights/grow-fast-or-die-slow-why-unicorns-are-staying-private
[iv] http://www.londonstockexchange.com/companies-and-advisors/aim/publications/documents/gteconomicimpactofaim2015.pdf
[v] http://www.oecd-ilibrary.org/economics/drivers-of-systemic-banking-crises_5kg3k8ksgglw-en?crawler=true
[vi] Cournède, B., O. Denk and P. Hoeller (2015), "Finance and Inclusive Growth", *OECD Economic Policy Papers*, No. 14, OECD Publishing, Paris
[vii] A person closely associated, such as a spouse, child and relative sharing a household
[viii] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/559219/bpe_2016_statistical_release.pdf
[ix] Deloitte (2014) Scale-up Challenge: An impact report by Deloitte

The Quoted Companies Alliance is the independent membership organisation that champions the interests of small to mid-size quoted companies. We campaign, we inform and we interact to help our members keep their business ahead. Through our activities, we ensure that our influence always creates impact for our members.

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