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The European Securities and Markets Authority (ESMA)
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1 August 2014

Dear Sirs,

ESMA Consultation Paper – MiFID II/MiFIR

Introduction

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-size quoted companies. Their individual market capitalisations tend to be below £500m.

The Quoted Companies Alliance is a founder member of European**Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

The Quoted Companies Alliance Legal and Secondary Markets Expert Groups has examined your proposals and advised on this response. A list of members of our Legal and Secondary Markets Expert Groups is at Appendix A.

Response

We welcome the opportunity to respond to this consultation and have focused our response to the consultation paper on inducements and SME Growth Markets.

We believe that ESMA's proposals on legitimacy of inducements to be paid to/by a third person will have an adverse effect on small and mid-size quoted companies' ability to raise finance by reducing the research available on these companies. We urge ESMA to reconsider their position on this and consider the detrimental impact this could have on growing companies that are essential for European economic growth.

We support the concept and introduction of SME Growth Markets. We view the introduction of SME Growth Markets as particularly essential as the MiFID I framework classifies existing growth markets for smaller companies (exchange regulated markets, such as AIM and ISDX in the UK and Alternext in France) as multilateral trading facilities ('MTFs'). This classification does not distinguish the primary market function that these markets serve from the purely secondary market functions played by almost all other MTFs. We believe that the primary market function deserves to be recognised and treated differently in order to facilitate access to capital by SMEs across Europe.

By defining SME markets as a separate type of trading facility, the opportunity will be created to deal with many significant regulatory issues as they affect SMEs. This will, in turn, allow a holistic approach to be taken to the many regulatory issues currently impeding access to non-bank finance by SMEs across the EU.

Responses to specific questions

2.15. The legitimacy of inducements to be paid to/by a third person

Q79. Do you agree with the proposed exhaustive list of minor non-monetary benefits that are acceptable? Should any other benefits be included on the list? If so, please explain.

No, we do not agree with the proposed exhaustive list of minor non-monetary benefits that are acceptable. ESMA should be adopting a principles-based approach to its advice on the Level 2 regulation. It is impossible to come up with an exhaustive list that will remain comprehensive and reflect market practice at all times. ESMA should be focusing on developing principles that market participants can then judge whether or not a benefit is minor and non-monetary.

Furthermore, we strongly believe that the proposals in section 2.15 will be detrimental to small and mid-size quoted companies' ability to raise finance and grow and we urge ESMA to reconsider these proposals from a smaller company's perspective.

We strongly believe that only allowing 'widely distributed' research as a 'minor non-monetary benefit' could further decrease the already limited amount of research there is on small and mid-size quoted companies, having a knock-on effect on liquidity in these companies' shares. We also believe that this will have a negative effect on the European investment industry as whole, independent research providers and fund managers – all whom play a vital role in financing growing companies. ESMA's proposals would result in all other research (such as meetings with analysts, models or bespoke reports) having to be paid directly by the asset manager.

We consider that the narrow focus of this proposal on transparency and client money is likely to have a great impact on sell-side economics, generating lower liquidity, greater volatility and higher bid offer spreads, as a result of less research and fewer brokers in the market. This would also create higher barriers to entry, as smaller asset managers would be disadvantaged regarding fixed costs and access to research compared to larger competitors.

Companies facing this adverse scenario will be subject to higher costs of listing, more share price volatility and reduced institutional access, which will culminate in them questioning the value of a public listing. We believe that the costs of research will increase and the volume and scope of research will fall, which will result in small and mid-size quoted companies seeing raising capital more difficult and reduce trading liquidity due to little research coverage. As we believe ESMA agrees, access to equity finance is fundamental for growth of small and mid-size companies in the EU and it should be encouraged, not hurdled.

All of the above conditions combined would hamper economic growth and investor returns. Moreover, this could also lead to greater market abuse, as the new direction on corporate access is already an incentive for investors to go directly to the company rather than via the broker.

Research is valued by companies as a service that enhances the quality of the portfolio management by increasing the asset managers' ability to access varied research and different perspectives. By reducing the sources of research, ESMA could be limiting the clients' and companies' chances of achieving better results and growth.

We would, therefore, urge ESMA to reconsider their interpretation of the Level 1 text and what constitutes a 'minor non-monetary benefit', taking into consideration the highly negative impact it could have on small and mid-size quoted companies.

Q82. Do you anticipate any additional costs in order to comply with the requirements proposed in this chapter? If yes, please provide details.

Yes, we anticipate that the costs of research will increase, as a result of pressure on the supply of research, especially in the case of research on small and mid-size quoted companies. Please see response to Q79 for further analysis.

6. Requirements applying on and to trading venues

6.1. SME Growth Markets

Q176: Do you support assessing the percentage of issuers on the basis of number of issuers only? If not, what approach would you suggest?

Yes, we agree that assessing the percentage of issuers on the basis of number of issuers only is an adequate approach.

Q177: Which of the three different options described in the draft technical advice box above for assessing whether an SME-GM meets the criterion of having at least fifty per cent of SME issuers would you prefer?

We agree with the preferred method put forward by ESMA, method iii ('at least 50% of the issuers admitted to trading on the SME-GM were SMEs based on an average of each month of the calendar year (the market capitalisation shall be checked at the end of each calendar month and an average shall be calculated on 31 December)'). We agree that this is the most precise out of the three methods. We believe that both method i and method ii could misrepresent the composition of issuers and may lead to a distorted view of the market, which could be unfair for issuers and investors.

Q178: Do you agree with the approach described above (in the box above), that only falling below the qualifying 50% threshold for a number of three consecutive years could lead to deregistration as a SME-GM or should the period be limited to two years?

We agree that three consecutive years is a reasonable period of time. However, we note that it is important for both ESMA and the market operators of SME Growth Markets to consider how they will manage the deregistration process. There may be a number of differences in terms of regulatory requirements that companies would have to start complying with if their SME Growth Market lost that status. This could have a detrimental effect on companies' ability to raise finance and, therefore, there should be a grace period after deregistration so that companies are able to adjust to any new regulatory requirements.

Q179: Should an SME-GM which falls below the 50% threshold in one calendar year be required to disclose that fact to the market?

No. We believe that, as explained by ESMA, this could have a negative impact by deterring SMEs from joining the market, making the recovery to the 50% threshold more difficult, and have an impact on the overall reputation of the market, which is also likely to affect the issuers.

Q180: Which of the alternatives described above on how to deal with non-equity issuers for the purposes of the "at least 50% criterion" do you consider the most appropriate? Please give reasons for your answer.

We support alternative ii; we believe that non-equity issuers should not be part of the calculation. There are some issuers who will have both equity and debt on the same market and it would create confusion if they were counted twice or, if option iii was taken, counted as an SME issuer for equity but not for debt or vice-versa**.**

Q181: Do you agree that an SME-GM should be able to operate under the models described above, and that the choice of model should be left to the discretion of the operator (under the supervision of its NCA)?

Yes, we agree that SME-GMs should be able to operate through the application of a number of different models and that MiFID should remain neutral as to which operating model the SME-GM operates. We believe that the choice of model should be left to the discretion of the market operator and that NCAs are in a better position to assess whether the proposed operating model is an effective way of applying the admission to trading requirements and subject to the local specificities of the market.

As we had previously argued in our response to the Commission's review of MiFID consultation in 2011, harmonisation in this area must take into account the need for SME Growth Markets to retain flexibility as to the specific market model and eligibility criteria. No one model will work for all European markets, as they all have different investment cultures. A level of flexibility must be retained at a Member State and market operator level to account for different local and market practices.

Q182: Do you agree that an SME-GM should establish and operate a regime which its NCA has assessed to be effective in ensuring that its issuers are "appropriate"?

Yes, we agree that the operator of an SME-GM should satisfy its NCA that it sets and applies criteria which are effective in ensuring that issuers are 'appropriate', as mentioned on paragraph 6.1.34.

We believe that an appropriate approach would be to allow the market operator to determine the eligibility criteria. These criteria would have the objective of allowing suitable small and mid-size companies to access SME-GM, while screening out those which are not investment-ready and encouraging those that are more suited to a non-SME-GM to apply for admission there.

Q183: Do you agree with the factors to which a NCA should have regard when assessing if an SME-GM's regulatory regime is effective?

We do not understand which 'factors' are referenced in the question.

We believe that the assessment should be made taking into consideration local factors, with a balance between flexibility and investor protection. In general, we agree with the possible requirements put forward in paragraph 6.1.30 (appropriateness of the issuer's management and board, appropriateness of systems and controls and adequacy of an issuer's working capital), subject to specific local considerations and implemented in a way that will not diminish the flexibility afforded to market operators.

As we had stated in our response to the Commission's review of MiFID consultation in 2011, SME Growth Markets should adopt rules which are equivalent to the principles set out in the Market Abuse Regulation and Transparency Directive to ensure that regulatory and admission requirements are adapted for small and mid-size companies, but without compromising investor protection.

Q184: Do you think that there should be an appropriateness test for an SME-GM issuer's management and board in order to confirm that they fulfil the responsibilities of a publicly quoted company?

Yes, although the SME-GM should be able to prescribe how such a test would be carried out in practice. As mentioned before, we believe that flexibility should not be diminished by prescribing further, detailed requirements in relation to corporate governance, systems/controls or working capital at a MiFID II level.

Q185: Do you think that there should be an appropriateness test for an SME-GM issuer's systems and controls in order to confirm that they provide a reasonable basis for it to comply with its continuing obligations under the rules of the market?

Yes, although the SME-GM should be able to prescribe how such a test would be carried out in practice. As mentioned before, we believe that flexibility should not be diminished by prescribing further, detailed requirements in relation to corporate governance, systems/controls or working capital at a MiFID II level.

Q186: Do you agree with i, ii or iii below?

We agree with option ii. We do not see this as presenting a problem for SME Growth Market issuers. Many are already used to having a working capital statement/requirement, as prescribed in Annex III of the Prospectus Directive. Where a SME-GM issuer does not have sufficient working capital, however, it should not preclude them from coming to market if there is clear disclosure of how that shortfall will be dealt with.

Q187: Are there any other criteria that should be set for the initial and on-going admission of financial instruments of issuers to SME-GMs?

No. As noted above, we believe that the assessment should be made taking into consideration national factors and the right level of flexibility and investor protection.

Q188: Should the SME-GM regime apply a general principle that an admission document should contain sufficient information for an investor to make an informed assessment of the financial position and prospects of the issuer and the rights attaching to its securities?

Yes, the SME-GM regime should apply a general principle that an admission document should contain sufficient information for an investor to make an informed assessment of the financial position and prospects of the issuer and the rights attaching to its securities.

Q189: Do you agree that SME-GMs should be able to take either a 'top down' or a 'bottom up' approach to their admission documents where a Prospectus is not required?

Yes, we agree that the SME-GMs should be able to adopt the approach they believe to be the most adequate regarding admission documents where a Prospectus is not required.

Q190: Do you think that MiFID II should specify the detailed disclosures, or categories of disclosure, that the rules of a SME-GM would need to require, in order for admission documents prepared in accordance with those rules to comply with Article 33(3)(c) of MiFID II? Or do you think this should be the responsibility of the individual market, under the supervision of its NCA?

We believe that MiFID II should not specify detailed disclosures or categories of disclosure regarding the admission documents to an SME-GM, but that instead this should be the responsibility of the market operator.

We note, however, that it should be specified in the technical advice that ESMA does not consider it appropriate to require that an admission document is formally 'approved' by an NCA or market operator, as mentioned by ESMA in the Consultation Paper (p. 6.1.48).

The 'approval' and/or pre-vetting process by a NCA or market operator could result in many companies having to incur additional costs and delays in accessing finance and is not generally relevant to investors. The success of AIM in the UK is a good example to support this argument and demonstrates that no significant detriment to investors is caused by the absence of the pre-vetting of an admission document.

Q191: If you consider that detailed disclosure requirements should be set at a MiFID level, which specific disclosures would be essential to the proper information of investors? Which elements (if any) of the proportionate schedules set out in Regulation 486/2012 should be dis-applied or modified, in order for an admission document to meet the objectives of the SME-GM framework (as long as there is no public offer requiring that a Prospectus will be drafted under the rules of the Prospectus Directive)?

As said above, we do not believe that MiFID II should specify detailed disclosures or categories of disclosure regarding the admission documents to an SME-GM, but that instead this should be the responsibility of the market operator.

We would like to point out that the changes introduced by the directive amending the Prospectus Directive - including the introduction of the Proportionate Disclosure Regime (PDR) for rights issues and companies with reduced market capitalisations and SMEs – have not been effective in practice. In the UK, not one company has opted to publish a proportionate prospectus for a rights issue or for a company with a reduced market capitalisation or SME since the regime was introduced. We believe that this is because the level of disclosure for a proportionate prospectus is not significantly reduced from that which is required in a full prospectus, and so, to mitigate risk and to avoid extra costs, companies just opt to produce a full prospectus.

We believe that, to ensure the success of SME-GMs, detailed disclosures or categories of disclosure regarding admission documents should not be specified by regulation and left to the discretion of the market operator.

Q192: Should the future Level 2 Regulation require an SME-GM to make arrangements for an appropriate review of an admission document, designed to ensure that the information it contains is complete?

We agree that the future Level 2 regulation should require an SME-GM to make arrangements for an appropriate review of a draft admission document. However, ESMA should not specify prescriptive requirements as to how the process should be carried out or what steps the process should include. This should be left to the discretion of the market operator.

We strongly agree with ESMA's analysis in paragraph 6.1.49 that the NCA should not be involved in this review of the draft admission document.

Q193: Do you agree with this initial assessment by ESMA?

Yes, we agree with the initial assessment. We agree that the idea of finding a middle ground, as explained in paragraph 6.1.51, is sensible and justifies applying more generous deadlines for issuers admitted to SME-GM. We also agree with ESMA regarding not imposing one or more acceptable financial reporting standard (p.6.1.29).

Q194: In your view which reports should be included in the on-going periodic financial reporting by an issuer whose financial instruments are admitted to trading on an SME-GM?

We agree with ESMA that the publication of annual and half-yearly reports would be sufficient. Any additional reporting would be more onerous than that which is required of companies on regulated markets as a result of recent changes to the Transparency Directive, which will abolish quarterly reporting by November 2015.

Q195: How and by which means should SME-GMs ensure that the reporting obligations are fulfilled by the issuers?

We consider suspension (such as applied by AIM in the UK) to be appropriate if reporting obligations are not fulfilled. While it does not ensure compliance, it is an appropriate measure to deter issuers from not fulfilling reporting obligations.

Q196: Do you think that the more generous deadlines proposed for making reports public above (in the Box above, paragraph 23) are suitable, or should the deadlines imposed under the rules of the Transparency Directive also apply to issuers on SME-GMs?

Yes, we believe that these more generous deadlines are adequate.

Q197: Do you agree with this assessment that the MiFID II framework should not impose any additional requirements/additional relief to those envisaged by MAR?

Yes, we agree that the MiFID II framework should not impose any additional requirements/additional relief to those envisaged by MAR.

Q198: What is your view on the possible requirements for the dissemination and storage of information?

We welcome ESMA's consideration of less burdensome rules on dissemination and storage than the ones established in the Transparency Directive. We believe that the storage of information should be published on the website of the issuer, as this is current market practice (as noted in paragraph 6.1.66) throughout Member States.

Q199: How and by which means should trading venues ensure that the dissemination and storage requirements are fulfilled by the issuers and which of the options described above do you prefer?

As noted above in our response to Q198, we believe that the storage of information should be published on the website of the issuer, as this is current market practice (as noted in paragraph 6.1.66) throughout Member States.

Q200: How long should the information be stored from your point of view? Do you agree with the proposed period of 5 years or would you prefer a different one (e.g., 3 years)?

We consider three years to be adequate to provide investors with a sufficiently long history of published regulatory information. However, a five-year period will not create an undue burden on SME-GM issuers.

Q201: Do you agree with this assessment that the MiFID II framework should not impose any additional requirements to those presented in MAR?

Yes, we agree that the MiFID II framework should not impose any additional requirements to those presented in MAR. We welcome ESMA's consideration for keeping an adequate level of consistency.

If you would like to discuss any of our responses in more detail, we would be happy to attend a meeting.

Yours sincerely,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Legal Expert Group

Gary Thorpe (Chairman)	Clyde & Co LLP
Maegen Morrison (Deputy Chairman)	Hogan Lovells International LLP
Sarah Hassan/ Hilary Owens	Practical Law Company Limited
Paul Arathoon/ David Hicks/ Tom Shaw	Speechly Bircham LLP
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David Davies	Bates Wells & Braithwaite LLP
Mebs Dossa	McguireWoods
David Fuller	CLS Holdings PLC
Stephen Hamilton	Mills & Reeve LLP
Nick Jennings	Faegre Baker Daniels LLP
Martin Kay	Blake Morgan
Gabriella Olson-Welsh	McguireWoods
June Paddock	Fasken Martineau LLP
Donald Stewart	Progility plc
Mark Taylor	Dorsey & Whitney
Anthony Turner	Farrer & Co
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