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The Quoted Companies Alliance

European Commission
DG Internal Market and Services
Unit B1 – Policy Development and Coordination of the Internal Market
Rue de Spa 2
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28 February 2011

Dear Sirs,

**European Commission – The Single Market Act**

***INTRODUCTION***

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation working for small and mid-cap quoted companies. Their individual market capitalisations tend to be below £500m.

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

Our ID number for the European Commission's register of interest representatives is 45766611524-47.

***RESPONSE TO QUESTIONNAIRE***

1. **Are you replying as:** Organisation
2. **Last Name:** Ward
3. **First Name:** Tim
4. **Type of organisation:** Trade Union
5. **Is your organisation registered in the Commission's Interest Representative Register:** Yes
6. **If you are a registered organisations, please indicate your Register ID number:** 45766611524-47
7. **Name of your organisation:** The Quoted Companies Alliance
8. **Name of your public authority**: N/A
9. **Country:** United Kingdom
10. **Email:** tim.ward@theqca.com

**Questions**

1. **What is your overall assessment of the Single Market Act?**

We welcome the proposals outlined in the Single Market, particularly those aimed at assisting small and medium-sized enterprises (SMEs) and access to finance (Proposal 12, 13, 14, and 16).

A successful return to economic health can only be brought about by encouraging and promoting investment in the areas where sustainable jobs can be created. We believe that SMEs are the engine for economic growth and jobs and key in driving European economic recovery.

At a time, when banks are reluctant lend and many business need to recapitalise, access to equity markets for SMEs is paramount. Part of this involves re-examining barriers to obtaining a listing and the ongoing requirements throughout the Financial Services Action Plan; but, it also involves ensuring that equity markets for SMEs have a strong investor base and liquidity.

We have welcomed the European Commission's efforts so far in taking accounts of SMEs' needs in the review of many of the Financial Services Directives in the past year, including the Prospectus Directive, MiFID, the Market Abuse Directive and Transparency Directive. However, the Commission should not stop short of taking a complete and holistic review of the burdens on quoted SMEs. It should examine overall what is appropriate and beneficial in terms of a regulatory approach for primary markets, rather than examining measures in a piecemeal approach in order simply to echo the current structure of the Financial Services Action Plan Directives. As such, we urge the Commission to develop a joint-up approach to reviewing SME's access to equity finance, rather than one that only looks at the issues in isolation of the current Directives in place.

2. **The Single Market Act proposes 50 actions: please indicate the actions you consider to be the most important: (up to 10 choices possible)**

12. SME access to finance
13. Small Business Act review
14. Accounting rules
16. Private investment and venture capital
28. Corporate governance

**If you wish you can state the reason for your choice:**

**SME access to finance and Small Business Act review**

As mentioned in our response to Question 1, we view SME access to finance as vital to encourage economic growth and sustainable employment opportunities throughout Europe. We view the review of the Small Business Act as part of this.

**Accounting rules**

We strongly support a review of the accounting Directives in 2011, as a means to simplifying accounting standards. We support the adoption of full IFRS for larger listed companies, but believe it is appropriate to recognise the difference in scale, and of resources available to, smaller listed companies and those companies quoted on 'exchange regulated' markets, which may have a capitalisation of just tens of millions of Euros compared to their global listed counterparts capitalised at many tens of billions of Euros. We therefore consider that both small companies listed on regulated markets and companies quoted on exchange regulated markets (such as AIM and PLUS-quoted in the UK) should be able to use a proportionate form of IFRS, rather than having to use full IFRS as at present. We consider that the 'one size fits all' approach to financial reporting by EU listed companies is not appropriate.

**Private investment and venture capital**

Encouraging private investment is key to improving access to capital for SMEs. In particular, we would urge the Commission to ensure that State Aid rules do not prohibit or overly restrain the creation and operation of venture capital schemes throughout the EU.

**Corporate governance**

We believe that effective corporate governance is important to developing sustainable and responsible business and also key in creating and maintain value for shareholders. We would urge the Commission in its review of corporate governance to keep the 'Think Small First' principle in mind and note that one size does not fit all, especially with regard to governance. Corporate governance should be appropriately tailored the size and stage of development of a business.

3. **Does the Single Market Act propose appropriate measures to address the issues/challenges that are identified?**

Yes

**Additional Explanation:**

We have evaluated this with regard to the specific areas that we have highlighted as most important in Question 2.

4. **Are there any other issues you consider should be addressed in the Single Market Act in the chapter on 'Strong, sustainable and equitable growth for business'?**

As mentioned in our response to Question 1, a strong investor base is vital to ensuring that SMEs can access finance. Investor enablement is something that the Commission should seek throughout its implementation of the Single Market Act.

Participation in primary market activity is currently restricted almost entirely to institutional investors. While this is a direct result of the regulatory landscape, we believe that far more could be done to facilitate participation by certain categories of private investors. We have outlined the areas below.

**Availability of Research**

We believe that the markets' health could be improved by better access to more research and analysis. We note that MiFID article 13(3) requires that conflicts of interest are to be managed to avoid damage to clients and that article 25 of the MiFID implementing directive (2006/73/EC) provides strict requirements to ensure the independence of investment research. While we fully appreciate the policy objectives underlying these rules, the unintended consequence which we have experienced since the implementation of MiFID has been that independent investment research on SMEs has effectively disappeared. While the work has largely continued, the product has simply become a marketing communication (financial promotion) within the meaning of article 19 of MiFID.

Unless the information contained in such communications is effectively approved by an authorised investment firm, it cannot be made available to anyone other than professional investors and certain other experienced or high net worth investors. Due to both the high costs of the approval process, the obvious difficulties involved in objectively attempting to verify investment opinions and the generally limited levels of interest in such material, issuers can no longer publish such material on their websites or make it generally available to interested parties.

The very practical problem which SME issuers face as a result is the considerable informational imbalance between the professional investment community and other investors. This leads those who invest, but are deprived of access to such information, to make investment decisions without the benefit of a level playing field.

The recent consultation paper on the Review of MiFID suggested, in effect, that disclosure may only be used as a last resort and suggests that more detailed prescriptive rules should be imposed. The Commission has not put forward any strong evidential base for the proposal (its suggestion that an investment firm will not be able to demonstrate compliance with MiFID through disclosure alone in some circumstances appears to be entirely a question of willingness to enforce existing provisions, and not a basis for new ones), but it does not identify what detailed provisions are to be introduced.

For SMEs whose instruments are traded, it can be difficult to ensure that potential investors and the wider market are served by well informed investment research (if any). In those circumstances we would be extremely concerned if more detailed conflicts of interest provisions made this position worse. We would strongly suggest that disclosure should become the primary tool when considering "independence" of research on instruments issued by SMEs. 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. As a result the potential conflict of interest should be managed through disclosure and other organisational means (e.g. actionable undertakings of independence by the analyst) so that the analyst's view can be presented to all interested parties.

**Business Angels**

In seeking to increase investment in SMEs, it may be worth considering the unintended consequences of the current professional client requirements in MiFID on Business Angels. A business angel investor, despite the fact he or she may be a high net worth individual with considerable understanding of the risks involved in investing seed capital or in a particular type of business, is unlikely to fulfil the requirements of the quantitative test, not least because the nature of angel investing is infrequent and often irregular. Therefore, these sophisticated investors often have to be treated by intermediaries as retail investors.

An exemption from the Quantitative Test for members of a Business Angel network should be considered to enable these investors to be more actively involved in the funding of SMEs. Alternatively, the Commission could look at changing the regularity of investments in unlisted firms required in the quantitative test.

**Conduct of Business Rules**

The financial crisis has shown that equity finance has a key role to play in financing private sector recovery with small to medium sized companies acting as a key contributor to this recovery. However the consolidation in banks, fund managers and brokers has had the side effect of pushing the minimum (economic) investable amount of these consolidated entities to levels which make it unattractive for them to invest in many smaller companies. A fund manager or stockbroker with tens of clients will be looking to invest significant sums in order for the allocation size for each client to be sensible at the same time as treating all their clients fairly.

Another issue which significantly restricts access to equity capital is the application by both private client and institutional investment managers of a 'model portfolio' approach. This effectively means that investment managers cannot favour any single fund or group of funds under their management over any other funds they manage. As a result investment managers who have large numbers of funds cannot make small investments. The distribution of a small investment across their portfolio would result in large numbers of small holdings, which would ultimately carry disproportionate administration costs. We believe that equity investments under €2m are particularly affected, but it may affect investments up to €10m.

5. **Are there any other issues you consider should be addressed in the Single Market Act in the chapter on 'Restoring confidence by putting Europeans at the heart of the single market'?**

No

6. **Are there any other issues you consider should be addressed in the Single Market Act in the chapter on 'Dialogue, partnership, evaluation: the keys to good governance of the single market'?**

No

If you would like to discuss any issues, we would be happy to attend a meeting.

Yours faithfully,

Tim Ward
<u>Chief Executive</u>

**APPENDIX B**

## THE QUOTED COMPANIES ALLIANCE (QCA)

A not-for-profit organisation funded by its membership, the QCA represents the interests of small and mid-cap quoted companies, their advisors and investors. It was founded in 1992, originally known as CISCO.

The QCA is governed by an elected Executive Committee, and undertakes its work through a number of highly focussed, multi-disciplinary committees and working groups of members who concentrate on specific areas of concern, in particular:

- taxation
- legislation affecting small and mid-cap quoted companies
- corporate governance
- employee share schemes
- trading, settlement and custody of shares
- structure and regulation of stock markets for small and mid-cap quoted companies
- political liaison – briefing and influencing UK Government, the City and Brussels
- accounting standards proposals from various standard-setters

The QCA is a founder member of European**Issuers**, which represents quoted companies in fourteen European countries.

**QCA's Aims and Objectives**

The QCA works for small and mid-cap quoted companies in the United Kingdom and Europe to promote and maintain vibrant, healthy and liquid capital markets. Its principal objectives are:

*Lobbying* the Government, Brussels and other regulators to reduce the costing and time consuming burden of regulation, which falls disproportionately on smaller quoted companies

*Promoting* the smaller quoted company sector and taking steps to increase investor interest and improve shareholder liquidity for companies in it.

*Educating* companies in the sector about best practice in areas such as corporate governance and investor relations.

*Providing a forum* for small and mid-cap quoted company directors to network and discuss solutions to topical issues with their peer group, sector professionals and influential City figures.

Small and mid-cap quoted companies' contribute considerably to the UK economy:

- There are approximately 2,000 small and mid-cap quoted companies
- They represent around 85% of all quoted companies in the UK
- They employ approximately 1 million people, representing around 4% of total private sector employment
- Every 5% growth in the small and mid-cap quoted company sector could reduce UK unemployment by a further 50,000
- They generate:
    - corporation tax payable of £560 million per annum
    - income tax paid of £3 billion per annum
    - social security paid (employers' NIC) of £3 billion per annum
    - employees' national insurance contribution paid of £2 billion per annum

The tax figures <u>exclude</u> business rates, VAT and other indirect taxes.

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