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Jonathan Hill, Baron Hill of Oareford

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Dear Lord Hill,

Call for Evidence – UK Listings Review

We welcome the opportunity to respond to your call for evidence on the UK's listing regime.

Executive Summary

There is a need for significant reform

This response makes the case for significant reform of the United Kingdom's (UK's) public equity markets. It briefly highlights key statistics, showing how the number of firms on public markets has been in decline for more than twenty years. The evidence points to a need for a new approach.

The solution is to create a Nasdaq-like market

The QCA believes the UK should channel the bulk of the reforms raised in this review, not into the Premium listing, but into a new market. This review presents an opportunity for the UK to emulate the success of the growth focused Nasdaq market in the United States (US).

The Standard Listing segment should be reframed to introduce choice and flexibility

The best means of creating a successful Nasdaq-like market in the UK would be by reinventing the Standard Listing segment to serve as a new growth platform for mid-caps.

The positioning of the market will fill an important gap

It will offer a progression path for firms that have outgrown AIM but would not yet be well suited to the Premium Listing.

Governance of the markets needs to be considered carefully

The way the markets are managed and regulated will be an important factor in ensuring each market best serves their constituent companies. The Financial Conduct Authority (FCA) should take the role of oversight here, looking across the markets to ensure their standards make sense in the "bigger picture". The governance of each market will have an impact on whether or not companies are included in mainstream indices.

Radical change is necessary

The UK's equity markets are demonstrably declining in attractiveness and the trend of the past two decades does not place us well for the challenges we face, particularly as we have left the European Union (EU). We need to grasp the opportunity that this gives us. Radical change is necessary to ensure the markets return to best serving companies and investors and we believe the key issue is filling the evident gap in the UK's offering. Creating a mid-tier Nasdaq-like market is necessary and action is needed urgently.

Introduction

In this response we concentrate on what should happen to address the key issues. We will not describe here the current or historic state of the UK's equity markets at length, as we believe that they are now well understood. Suffice to say, it is accepted that listing shares on the UK stock markets has become less attractive for many companies. For the past twenty years, the total number of listed companies in the UK has fallen consistently. Increased regulation, the costs of compliance and the growth of private equity have contributed to the decline of listings.

Since 2007, the number of companies quoted on the Main Market has declined by 25% and the number of companies quoted on AIM has declined by 49%[1]. Studies, such as the *QCA/Peel Hunt Mid and Small-Cap Survey*, have suggested reasons for this decline, with 60% of respondents attributing this to overly burdensome listing requirements[2]. Appendices 2 to 5 reveal the extent of decline in the number of companies on the Main Market and AIM and the decline in number of companies coming to these markets.

The fact that the number of total quoted companies has been falling for so long is evidence that significant reform is necessary, as simply tweaking the current system will not have the desired effect of reversing such an embedded trend. It is clear that we cannot simply look at the number of companies conducting an Initial Public Offering (IPO) as it is being outpaced by a trend of companies leaving the markets. We believe that there is need for significant change as the UK equity markets are arguably not fit for the future.

Need for significant reform

The QCA is encouraged by the focus and timing of the review as we believe significant reform is necessary to ensure the UK has a continuum of attractive equity markets for growth companies, and that these are able to raise finance, create intellectual property, generate jobs and distribute wealth across the UK.

The current structure of the UK's public equity markets, as well as the rules that govern them, are antiquated. This is not only due to the period of time in which they have been in operation, but due to the significant pace of change of political, social and economic factors. The lack of change to the markets and the inability or unwillingness to adapt to these developments has meant that there is limited appeal for potential new companies to come to the public markets. The apparent market inflexibility does not allow new growth companies to emerge and prevents them from overtaking and challenging the existing top companies on the UK's exchanges.

As an example, the continuation of the requirement relating to track records would permanently inhibit the UK's ability as a listing venue. The fast-evolving nature of the global economy has meant that it is now widely accepted that companies can reach a level of maturity much quicker than has

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[1] Report by Hardman & Co and the QCA of May 2020: *Are the public markets closing to smaller companies – The evidence from the past 20 years in London*

[2] QCA/Peel Hunt Mid and Small Cap Survey, conducted by YouGov: *To be or not to be….a public company – the growing de-equitisation crisis.*

historically been considered the case. Without addressing these requirements, many potential public companies will have already made their decisions regarding permanent capital structures by the time they meet the requirements. This has serious implications for UK capital formation and job creation.

The UK should seek to celebrate and encourage the role of public companies and their significant contribution, both regionally and nationally, to the UK economy. It is estimated that the small and mid-sized quoted company community alone directly employs nearly 1.5 million people outside London and across the UK's nations and regions[3]. This demonstrates their potential importance in addressing regional inequality.

The potential changes outlined in this review, namely, to free float requirements, dual class share structures, track record requirements, prospectuses and dual and secondary listings are centered on the Premium Listing segment of the Main Market. Whilst we support the exploration of potential changes, we anticipate that such changes will not be universally welcomed by the investment community and other stakeholders if directed at the gold plated and strictly regulated Premium Listing segment.

It is time to create a Nasdaq-like market to complement the NYSE-like Premium Listing segment

The QCA therefore proposes a full-scale overhaul of the Standard Listing segment, replacing it with a growth market that will emulate the success of Nasdaq in the US, through a mixture of proportionate regulation and assertive marketing. This is the context in which we believe any changes would be most appropriate and would enable stakeholders to have an understanding of the relative risk of both markets, a completely new Standard Listing and the existing Premium Listing.

Whilst it is likely that this market will have significant appeal to tech companies, we envisage that the market will provide listing opportunities for a range of companies in all sectors of the economy and across geographical regions. It is not the intention of this proposal to copy the Nasdaq model identically, but to build a market that is designed specifically for the UK environment.

The Standard Listing segment should be reframed to allow more choice and flexibility

The QCA's approach is that the Standard Listing segment should be completely reframed and allow for more choice by companies, both in terms of the market on which to list and how to use alleviations such as those covered by the questions in this review. Companies can already avail themselves of some of these, but they are available in the wrong context as the current Standard Listing segment is a tarnished product, even when portrayed as a High Growth option.

We do not seek to complicate the existing regime but believe that replacing the Standard Listing segment with a new market will be a vast improvement to the structural makeup of the UK's capital

[3] Hardman & CO. and the QCA, May 2019, How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues, available at: https://www.hardmanandco.com/wp-content/uploads/2019/05/How-small-and-mid-cap-quoted-companies-make-a-substantial-contribution-to-markets-employment-and-tax-revenues.pdf

markets. It is a commonly held belief that the Standard Listing segment is a tarnished product. It is seldom used, and this is, in part, due to its branding issues. In distinguishing the markets by assigning them the labels "Standard", which is referred to as the EU minimum, and "Premium", which is referred to as gold-plated, creates an immediate indisposition towards the Standard Listing segment, with many companies and investors viewing this as unattractive from a reputational point of view.

As such, we recommend a new, re-branded market that is aimed at specific types of companies and is more fit for purpose. This will encourage growth companies, tech, e-commerce and science in particular, to remain in the UK and create wealth and jobs. It is in this new market where changes to free float requirements, dual class share structures, track record requirements, prospectuses and secondary listings can be made. It will also mean that any reforms of the Premium Listing segment can remain conservative and stocks on that market will continue to fit the low-risk appetite of investors that value strictly regulated stocks, in a similar way to the New York Stock Exchange (NYSE). Companies will be able to choose which market serves their needs best.

We believe that a separate trading facility akin to that offered to securities admitted to the current Standard Listing segment should remain in place for specific types of securities such as zero-rated preference shares, shares offered as part of employee incentive plans and the like. However, that need would be met by a separate market directed at those categories of securities. That market would retain the minimal standards which currently apply to the Standard Listing segment.

The positioning of the market will fill an important gap

A new Standard Listing platform (a Nasdaq equivalent) would become the middle tier of the stock market. We envisage that the new market would sit between AIM quoted companies that are predominantly smaller (a market equivalent does not exist in the USA) and Premium Listed companies which are typically much larger (the NYSE equivalent).

The London market also includes the Aquis Stock Exchange (AQSE), which provides an alternative trading facility for growth companies, with the majority of market constituents currently being small/micro-caps that are typically smaller than those on AIM.

During the QCA's internal consultation around this proposal, there was significant discussion around three questions: (i) whether there is a need for a new market given that the UK already operates a bipartite structure similar to the US with AIM and the Main Market in the UK and Nasdaq and the NYSE in the US; (ii) whether AIM could grow to become more like Nasdaq; and (iii) why AIM companies can't just graduate to the Main Market once they reach a certain size.

In relation to the first question, the Main Market, whilst smaller, can be considered on many levels to be similar to the NYSE. However, AIM is a unique market and is different to every other market in the world. Therefore, it is important to stress that, whilst the bipartite structure seemingly appears similar, the markets, and in particular AIM and Nasdaq, are entirely different.

By way of illustration, there are around 850 companies on AIM with a combined market cap of £104 billion[4]. In contrast, the Nasdaq-100 (which is made up of the 100 largest companies on the Nasdaq) had a combined market capitalisation of $9.8 trillion (£7.3 trillion) at the end of 2019[5]. Furthermore, and despite being at an all-time high, the average market capitalisation of an AIM company (as at the end of September) was £130.6 million, and the median market capitalisation was £31.8 million[6]. This illustrates the stark difference between the two markets and demonstrates that there is no Nasdaq equivalent in the UK.

Regarding the second question, we do not believe that AIM could have the potential to grow and compete with Nasdaq in the medium term. In addition, it is the view of the QCA and many AIM market participants that this is highly undesirable. AIM is unique in its approach and composition and, as a result, is the most successful growth market in the world. It is imperative that this success continues, and small and mid-sized quoted companies continue to have a market appropriate for their growth and development. As such, it is important that AIM does not grow in such a way that means it is no longer appropriate for the companies in which it was originally designed for. A significant growth in the combined market capitalisation of AIM companies would likely result in the erosion of reliefs and the flexibility of the market, which are two of the crucial elements of AIM's success.

Finally, and whilst AIM companies do occasionally graduate to the Main Market, there is only a handful that do so. In the last 10 years there have only been 41 companies that have transferred from AIM to the Main Market, and in that same period, 43 companies have transferred from the Main Market to AIM[7]. This is due to the disproportionately higher levels of regulation on the Premium Listing segment, the loss of tax advantages for investors on moving to the listed market and the more flexible and lighter touch regulation on AIM. There is the option of the Standard Listing segment, but this is viewed as unattractive for the reasons outlined above, as well as some investors preferring an AIM quotation over a Standard listing due to the day-to-day supervisory role of Nominated Advisers (Nomads). Both the Standard and Premium Listing segments have no requirement for such an adviser.

We believe that, on balance, these arguments support our proposal for the creation of a new, Nasdaq equivalent market.

The graphic below demonstrates how the three markets would be differentiated.

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[4] Source: LSE website, available at: https://www.londonstockexchange.com/raise-finance/equity/aim

[5] Source Nasdaq website, available at: https://www.nasdaq.com/nasdaq-100

[6] Source: Allenby Capital Limited website, AIM Market Update Q3 2020, available at: http://www.allenbycapital.com/20201029%20-%20AIM%20Market%20Update%20Q3%202020%20-%20Allenby%20Capital%20(1).pdf

[7] Source: LSE website, available at: https://www.londonstockexchange.com/statistics/new-issues-further-issues/new-issues-further-issues.htm

	Primary Listing		New Market / Standard Listing		AIM Listing	
	Current regime	QCA proposals	Current regime	QCA proposals	Current regime	QCA proposals
Minimum free float	25%	25%	25%	If below 25%, FCA to step in where this is deemed inappropriate or to the detriment of the investors	No minimum at the discretion of AIM	No minimum at the discretion of AIM
Dual class share structures	No	No	Yes	Yes	At the discretion of AIM	At the discretion of AIM
Track record	3 years or shorter period if applicable	3 years or shorter period if applicable	3 years or shorter period if applicable	No fixed period with greater flexibility regarding what can be provided as evidence of a track record	No formally fixed period	No fixed period with greater flexibility regarding what can be provided as evidence of a track record
Prospectus	Prospectus required	Prospectus required	Prospectus required	QCA domestic securities offering document	Admission Document required. Prospectus required for public offers.	QCA domestic securities offering document
Dual and secondary listings	Yes	Yes	Yes	Yes	Yes – at the discretion of AIM	Yes
Min Market Capitalisation	£700,000	Flexible (approximately > £10 billion)	£700,000	Flexible (approximately £500 million - £10 billion)	None	Flexible (approximately £0 - £1 billion)
Regulated market[8]	Regulated	Regulated	Regulated	Regulated	SME Growth Market	SME Growth Market

We provide a detailed explanation of our reasoning for the proposals in our answers to the questions posed in the review below.

The creation of a middle category will provide a smoother growth path for ambitious companies. The QCA's view is that AIM/AQSE companies would typically have a market capitalisation of up to £1 billion, the new mid-market companies would typically have a market capitalisation between £500 million and £10 billion and the largest companies with Premium listings would typically have a market capitalisation over £10 billion. However, we would like to emphasise that these market capitalisation figures are indicative and are merely used to demonstrate the expected size of companies on each of the markets. We are not proposing that there should be rigid adherence to meet these thresholds. There will be flexibility so that companies are able to choose the market appropriate for their individual circumstances.

Smaller companies on the Premium Listing segment could choose to remain on the Premium Listing Segment but in doing so will be aware that the rules will be designed with the largest companies in mind. In keeping with the market framework, companies would also be able to choose their market, with an awareness of the difference in rules, risk profile and profile of investors.

[8] With the UK's departure from the EU, the relevance of the current market categorisation may be subject to modification under future domestic law

It should also be clear that the creation of a new market would not be designed to attract companies based solely on their size. The key features of companies on the new market would also be growth potential and agility. Their investors might therefore have a different general risk appetite. So, it is likely there would be some size overlap between companies on the three different markets. Some companies would see themselves as 'graduating' and maturing through the different markets while others will IPO directly onto a market and remain there as it best suits their vision.

By creating a new, well-promoted segment on the regulated market, the London Stock Exchange brand can be reinforced. "Listed on the London Stock Exchange" has strength and meaning and can be applied equally to both segments, so long as the Nasdaq-like segment has backing from the whole ecosystem in terms of enthusiasm, resource and promotion.

Governance of the markets needs to be considered carefully

The way the markets are managed and regulated should be considered very carefully to ensure that the distinction between them is enhanced and retained and that there is appropriate competition. The FCA should be charged with ensuring that there is appropriate, proportionate, and defined governance for each market segment. This should be completed following consultation with the stakeholder groups of the different markets in order to ensure that the governance model is fit for purpose for the specificity of each market.

In turn, the governance environment applied to companies on the new market will have an effect on mainstream indices. Index providers will decide for themselves whether to include companies in the Nasdaq-like segment in their mainstream indices. It should be noted that their decisions are often made by independent committees populated by investors; the bias of investors to favour lower-risk options may adversely affect the potential success of this market in the short-term. New indices will have to be commissioned and sold to investor groups and into enterprising investment funds, meaning the positioning and purpose of the new market will have to be clearly communicated.

The new market will be the place for introducing choice and flexibility

It is in this new market where free float requirements, dual class share structures, track record requirements, prospectuses and secondary listings can be reframed effectively. This market would be attractive for companies considering a flotation at an intermediate stage of growth while not affecting the rationale of the Premium market to prevent investors feeling that important protections are being lost. It would be designed to attract foreign companies as well as retaining UK founded companies.

Radical change is necessary

The UK's equity markets are arguably not fit for the future nor fit for the present in serving the needs of both companies and investors. Radical change is necessary, and we believe there is a glaring gap in the UK's offering. A mid-tier Nasdaq-like segment is necessary in order to complement the UK's highly

successful and flexible SME Growth Markets and the highly regulated Premium Listing segment. Action is needed now.

We have consulted with many of our members, drawn from our board and Expert Groups in order to produce this paper. Membership and details about our board and Expert Groups can be found on our website at www.theqca.com.

Thank you for the opportunity to contribute to your review. We would very much like to add further context to our submission once you have had a chance to consider our proposals.

Yours sincerely,

Tim Ward
Chief Executive

A company limited by guarantee registered in England
Registration Number: 4025281

Our responses to the questions posed should be considered in the context of our proposal to create a Nasdaq-like middle tier. Should the creation of a new market be deemed unachievable, then we would propose that alleviations be applied to the Premium Listing segment. However, this would be a messy compromise and affect the ability of investors to judge the overall market risk.

Free Float Requirements

Q1.1 Is the UK's 25% free float requirement calibrated at the right level, and should it be changed? If so, how?

The current Listing Rules allow, by way of derogation, for a free float amount less than 25% (and as low as 10%) where the issuer can demonstrate sufficient liquidity. This is the wrong way round. Companies, with their advisers, should be able to choose a free float that they consider appropriate, with the FCA able to veto this only if it is in the public interest to do so.

The purpose of the 25% free float requirement is to maintain liquidity and to help to provide investors with meaningful stakes in shares, allowing them to influence governance. A relaxation of this requirement could potentially run counter to the desired outcome of the policy. These components are synonymous with the robust and fixed nature of the Premium Listing segment. Therefore, a change in the free float requirement for the Premium Listing segment would not necessarily be seen as desirable by many stakeholders.

However, there are instances in which a lower free float may be effective and desirable. For this reason, and whilst some QCA members do not consider the 25% free float requirement, as contained within the Listing Rules, to be particularly high, we do believe that there is benefit in having more flexibility. We believe this would be best achieved in a new market, so that companies would benefit from having choice.

Having a prescribed free float requirement is unnecessary and reduces the relative attractiveness of the UK's markets. As the objective of this review is to create deeper, attractive and welcoming UK equity markets, we believe that free float requirements should be eased for the new market. We see merit in moving away from prescription and increasing flexibility.

Our reasoning for this is twofold.

Firstly, we believe that the introduction of an enforced minimum free float – either by value of company or size of shareholding floated – represents an unnecessary imposition on companies. The regulator is effectively making market decisions which can be better made by market participants. The way in which free float is defined is convoluted. This adds additional weight to the argument that there should be flexibility, with the ultimate choice resting with the issuer, not the regulator.

Secondly, we note the added value for markets, both domestically and overseas, that do not have free float requirements. For instance, growth markets, such as AIM and the AQSE, have significantly more appeal for smaller companies seeking a listing, as these markets maintain flexibility, inter alia, relating to minimum free float requirements. The imposition of a minimum free float requirement on issuers requesting admission to trading on these exchange venues would dissuade many companies from using public markets to secure new growth capital.

As a result of the above, we believe that companies, following consultation with their investors and advisers, should have the ability to determine their own level of free float appropriate to their individual circumstances. In order to do so, we suggest a reconfiguration of the current Listing Rules for the new Nasdaq-like market. The current law embodied in the Listing Rules only allows, by way of derogation, for an amount less than 25% where the issuer can demonstrate sufficient liquidity. We suggest that this is changed so that the Listing Rules for the new market allow an amount less than 25% unless the regulator can demonstrate the company will not have sufficient liquidity. This allows companies on the new market to determine the free float that is appropriate for their specific circumstances, as well as maintaining the power of the regulator to determine if a free float below 25% would be potentially damaging to the public interest.

In addition, and in order to ameliorate potential concerns surrounding a more limited role for the regulator, we propose that a requirement is introduced for companies to appoint a financial adviser during the IPO of a company seeking admission to the new Nasdaq-like market. This role would be similar to that performed by a Nominated Adviser on AIM, or a sponsor on the Premium Listing segment in assessing the suitability of the company for a listing and the corresponding appropriateness of the company's free float. This would help the company to arrive at an informed decision regarding its level of free float following the provision of advice from the adviser. That said, we believe that a free float of less than 10% is likely to be undesirable in almost all cases. Accordingly, if a minimum amount is to be prescribed by future legislation, 10% would be a reasonable figure to adopt (whilst maintaining the power of the regulator to step in in any case where a free float of less than 25% is considered to be inappropriate).

We believe that this would help to attract both domestic and overseas prospective companies to UK markets, who do not want to give up a significant portion of their business, whilst ensuring the regulator has adequate powers to ensure protections by preventing certain free floats below 25%.

Q1.2 Is there evidence that you can provide to assess potential risks to liquidity from alternative levels?

We recognise that, in order to ensure liquidity, it is important to issue a certain level of shares. However, we believe strongly that a company, following discussion with its investors and its financial adviser, is in the best position to determine the level of free float appropriate to its needs and individual circumstances, rather than requiring it to adhere to an arbitrary level of free float.

Furthermore, and as stated in our answer to Q1.1, the financial adviser would use their expertise and significant knowledge of the market to ensure that the level of free float for a company will be such that it provides a sufficient level of liquidity.

In deciding the level of free float, it is also important to take into consideration the market capitalisation of the company in question. With the anticipated market capitalisation of companies on the new Nasdaq-like market being between £500 million and £10 billion, there is still likely to be sufficient liquidity with a reduced free float. For instance, a 10% free float of a company with a £5 billion market capitalisation would generate more liquidity than a 25% free float of a company with a market capitalisation of £500 million.

Furthermore, we believe that there are other more impactful determinants that affect the level of liquidity and price formation. For instance, the number, nature, diversity and breadth of investors involved with the company, the type of roadshow held by the company and the level of information provided by the company have a greater impact on liquidity and price formation.

Q1.3 Are there other changes or alternative measures to the free float requirements that the review should consider?

Free float should not be determined by reference to narrow metrics such as all shareholders holding less than 5% or 10% of a company. As stated above, the number, nature, diversity and breadth of investors should be considered in the round. Overseas investors, for instance, that regularly trade on the London markets may be included.

Dual Class Share Structures and other owner-control mechanisms

Q2.1 Should dual class share structures be permitted in the Premium listing Segment of the London Stock Exchange? If so, what limitations should apply?

Inevitably, certain passive investors using Exchange Traded Funds (ETFs) and other trackers would be forced into investing in companies with dual class share structures if they are included in mainstream indices. Furthermore, we recognise that some active investors also view dual class share structures as higher risk, and therefore will choose not to invest in companies that operate these structures.

A company that has not developed to a stage where the founder is ready to give up control is likely to be too high a risk to be included in the Premium Listing segment. In addition, if there is more than one share structure allowed, this increases the governance risks associated with investing in such companies. It is important for many investors in companies within the Premium Listing segment to have influence over governance standards in order to contain risk to an appropriate level.

For this reason, we believe that it is important to maintain the lower-risk profile of the Premium Listing segment.

However, in order to encourage entrepreneurship in the UK's markets, we think that dual class share structures should remain an option for companies (it is permitted in the Standard Listing segment). We believe that permitting dual class share structures on a Nasdaq-like market would attract companies earlier in their maturity. Rigid adherence to certain shareholder protections, such as the rules preventing dual class share structures in the Premium Listing segment, has adversely impacted the effectiveness of the UK's public equity markets in providing scale-up capital. It should be the company's prerogative to determine its own share structure, with investors then being able to price this into their valuation.

A dual class share structure allows a company to raise capital while management retains control over the company's affairs. This can facilitate the long-term health of the company because it limits the pressures exercised by the market and investors, who do, in many instances, favour short-termism. Dual class share models exist amongst tech, science, and other high-growth companies, where the founders have an interest in preserving this ownership structure.

In recent years, we have seen that tech companies have the potential for exponential growth, far greater than any other sector. It can be argued that this growth derives from the vision of the company's founders and their ability to innovate.

The reasons to permit dual class share structures are particularly salient due to there being multiple overseas exchanges that allow these share structures, including New York, Hong Kong, Tokyo, Singapore, Sweden and Italy. As a result of this, there is a tendency amongst companies, in particular fast-growing tech and other innovative companies, to explore markets outside the UK that allow such share structures. There are consequences to this; namely, a resulting loss of UK-based intellectual property and liquidity, and loss of jobs both for local/regional economies and the UK economy as a whole.

In light of this, we note that there is a global trend towards flexibility in voting rights. The New York Stock Exchange (NYSE) has permitted differentiated voting rights since the 1980s, which has undoubtedly contributed to the success of companies, such as LinkedIn, Zillow, Square, Yelp, First Data, Facebook and Google. In addition, the Hong Kong Stock Exchange (HKEX) reformed its rules in 2018 to allow dual class share structures. This followed the decision of Alibaba to IPO on the NYSE after its dual class share structure was refused by the HKEX. Similarly, the Singapore Stock Exchange (SGX) revisited its rules around dual class share structures. There is a global trend towards flexibility, highlighting this restriction in the UK, which may be deterring companies from listing here.

Not only this, but there are also examples of successful companies in the UK who operate a dual class share structure on the Premium List segment. Daily Mail & General Trust PLC, which listed in 1932 (and is the oldest company on the market), and Schroders PLC, which listed in 1959, for instance, both operate dual class share structures. This demonstrates that companies in which founding families retain a large interest can still exhibit longevity.

Finally, BEIS and the FCA have shown an interest in considering the introduction of dual-class share structures and allowing controlling interests. For instance, in a 2017 discussion paper, the FCA consulted on the effectiveness of primary equity markets in the UK, asking about dual class share structures amongst the proposals. In addition, the FCA created a new category in the Listing Rules for Premium Listings of sovereign-controlled companies in order to attract Aramco to London. This would suggest that the FCA is ready to respond to competitive pressures from other markets, as well as indicating that there is a recognition that change is needed.

A move to allow dual class share structures on the new Nasdaq-equivalent market would send a welcome signal that the UK seeks to encourage companies to list when they would previously be forced to consider alternative options.

In terms of the limitations that should apply, we believe that dual class share structures should be permitted for any new company joining the new market but that this should then fall away after the company has been on the market for a certain period of time. We envisage that a company would not exceed a ten-year time period in operating a dual class share structure. However, rather than implementing a regulatory requirement for the sunset clause, we propose that companies should engage with their investors on the appropriate time frame for moving away from such a share structure and that period should be stated at the time of adoption of the dual class structure. We believe this is necessary as some companies will require far longer sunset clauses than others in order

to implement their vision. Companies already on the market would not be able to retrospectively apply new structures.

In order to accommodate the use of dual share structures it would be necessary to address takeover rules (as has been the case in Sweden), to adopt robust governance and related parties' regimes and to adopt rules for the full disclosure of the risks associated with the dual class share structure.

Furthermore, we note that both HKEX and SGX have established effective mechanisms to mitigate the erosion of corporate governance, which the UK could consider adopting for the new Nasdaq-like market. At a high-level, these safeguards include:

- Applicants seeking admission needing to demonstrate the necessary characteristics of growth and innovation;
- Restrictions on implementing dual-class voting arrangements after listing;
- Restrictions on holders of weighted voting rights, such as identifying holders and potential future holders at listing;
- Voting powers not exceeding 10 times the voting power of ordinary shares;
- Certain matters being reserved for one vote per share; and
- Ordinary shares being entitled to a minimum percentage of votes at shareholder meetings.

Q2.2 What demand is there for DCSS among issuers and what are the benefits and risks for investors? Do you have any evidence to support this?

A dual class share structure allows a company's owner to retain greater control of their company to deliver on their long-term strategy or vision. This is especially beneficial for earlier-stage growth companies that may have relatively volatile financial results during their mid-stage development and allows them to mature during this stage with greater confidence. Therefore, the ability of a company to operate a dual class share structure helps to encourage entrepreneurship, as well as helps to avoid a situation in which a company either decides not to list, or to list in an overseas jurisdiction. This has a multitude of positive implications, as outlined in our response to Q2.1 above, such as in enhancing liquidity, maintaining UK-based intellectual property and increasing employment.

In respect of the benefits and risks for investors of dual class share structures, we have the following observations.

Benefits

- Adopting dual class share structures enables a longer-term strategy to be employed by the company, which, in turn, could translate to increased shareholder value and improved share price performance;
- Investors have greater investment opportunities due to a deeper pool of companies on UK markets as they are less inclined to move to overseas jurisdictions that operate a dual class share structure;
- Over time, and as long as the company operates within their disclosed governance structure, trust can develop in the performance of the board;
- Whilst the controlling shareholder holds ultimate voting control, they may hold the same economic rights as other shareholders;

- For smaller investors, whilst the impact of their vote is largely ineffective, it still provides the opportunity to invest in a promising company, contributing to social value and wealth distribution; and
- More companies listing will create more UK (and regional) jobs.

Risks

- Some investors will have a specific mandate that prevents them from investing in companies with dual class share structures;
- A dual class share structure could make it difficult for investors to track how the ownership of the company changes in the shareholder register;
- Dual class share structures limit or reduce investor protection. There are specific examples, such as WeWork, where the dual class share structure has been abused by the founder, which has caused detriment to the shareholders;
- A decrease in the voting rights of a main shareholder could result in investors reaching or even exceeding voting thresholds set out in their own internal rules; and
- The effect of a dual class share structure could lead to a reduction in the value of the company overall, which will raise the cost of capital, as the structure is perceived as riskier to invest in from a governance perspective, which is why many large institutional shareholders demand a one-share, one-vote share class structure.

Notwithstanding this, we note that there is no clear evidence that dual class share structures either enhance or detract from the performance or valuations of the company in the long-run. For this reason, we stress that the observations outlined above are not absolute.

In addition, and whilst the risks of dual class share structures may be more apparent when considered in isolation, for instance in raising the cost of capital, our proposal when taken as a whole will ameliorate these issues to reduce the cost of raising capital.

Q2.3 Are there other ways of ensuring London's high standards of corporate governance are maintained while allowing DCSS in the Premium segment?

In addition to our comments in response to Q2.1 above, and in order to ensure that London's high standards of corporate governance are maintained while allowing dual class share structures, the communication between the company and its investors is important. It is imperative that the company is clear in its communications and sets out its intentions.

This could be achieved by the company issuing a binding statement, where the company sets out its plans and objectives. If the company wishes to alter its statement and significantly change its intentions, we believe that the company should have to consult its shareholders before doing so, and have this issue reserved as being one vote per share. There should be a notice period, and, in some cases, sanctions issued by the regulator for breaking the statement, in the same way that the Takeover Panel monitors undertakings made by a successful offeror.

Track Record Requirements

Q3.1 Do track record requirements prove a barrier to certain types of company? If so, should the UK consider allowing further flexibility in track record requirements?

Yes – we believe that track record requirements can prove to be a barrier to entry to the UK's markets for certain types of companies. Companies can find it difficult to work out when their track record meets the requirements of the rules. This represents an unnecessary burden on companies and could potentially deter promising companies (including those built up by making a number of recent acquisitions) from seeking a listing, or they may opt to list elsewhere. In particular, certain tech/e-commerce start-ups with especially high growth over a short period of time may find it difficult to meet the track record requirements when considering a listing. These are precisely the types of companies that the UK should be aiming to attract and foster.

As previously mentioned, we believe that not addressing the question of track record requirements permanently impairs the UK's ability as a listing venue, with follow-on consequences for UK capital formation and job creation. Due to the pace of change of an economy that is continually adapting to new digital and sustainability-related realities, it is now widely accepted and recognised that business models can reach a degree of maturity in a much shorter time frame than has been the case historically. As a result of this, by the time many potential public companies meet the requirements, the decisions regarding permanent capital structures will have already been taken. A failure to address this issue runs the risk of permanently relegating UK equities as a whole to a second-tier equity venue and suffocates the potential emergence of successors to existing UK global champions currently wrestling with the challenges posed by digital and sustainability agendas.

Dispensations have been created by the FCA for sovereign-owned companies in the Premium Listing segment. There are also dispensations for scientific based companies and property companies.

However, on balance, we believe that track record requirements are, in most instances, an important feature of the Premium Listing segment. Track record requirements can help to ensure a business demonstrates a certain level of maturity and helps mitigate the risk of investing in a company without a proven business model. Where companies are unable to meet these requirements and do not have a proven business model, it is likely that they would be more suitable for another market, such as the one proposed.

For this reason, additional flexibility regarding track record requirements should be introduced on the new market. This would ensure that the relatively lower-risk profile of Premium List companies is maintained, but will allow promising companies to enter a highly-regarded, regulated market with less emphasis on needing to meet fixed requirements. This would be particularly welcome to high-growth tech companies, who would have been previously unable to meet track record requirements and this will also help to ensure the UK remains competitive against Nasdaq and other markets.

Furthermore, we do not think that having reduced track record requirements on the new market will be unattractive from those investors who want exposure to a variety of risk profiles and sectors. It is the case that, by law, investors must have the necessary information to make an informed investment decision, and whilst a company's history remains important, it is an assessment of future performance

that can be of greater significance. The quality and track record of the board and management often carries weight.

Q3.2 What kind of extra flexibility could be offered regarding track record requirements?

For the reasons outlined in our response to Q3.1 above, we believe that the regulator should be able (and willing) to derogate from these requirements for certain companies who are seeking a listing.

We believe that this should be done on a new Nasdaq-like market. It may be necessary for additional comfort regarding funding and future viability to be required.

This would be beneficial to companies such as, but not limited to, certain high-growth tech or healthcare companies. When these companies are unable to conform to track record requirements to be eligible for the Premium Listing segment, alternative measures of performance could be considered to allow them entry to either that segment or the new market.

In addition, track record requirements have been particularly onerous for acquisitive companies where the FCA has required these companies to meet the 3-year track record requirement. For this reason, we believe that additional flexibility around acquisitive companies should also be permitted.

Prospectuses

Q4.1 Are the prospectus requirements and situations in which prospectuses are required appropriate? Are the thresholds for a prospectus to be produced calibrated appropriately to the size and depth of UK markets, or for types of issuer already held to high disclosure standards?

No – we do not believe the prospectus requirements and situations in which prospectuses are required are appropriate.

In respect of the prospectus requirements themselves, we believe the volume and complexity of these requirements actively inhibit access to the public equity markets, and in particular, for smaller companies. These requirements have increased the initial and ongoing costs of securing and maintaining a listing/quotation on the UK's exchanges. As a result of the UK's withdrawal from the EU, we are presented with a unique opportunity to recalibrate our securities markets and tailor them, so they are designed specifically for the UK.

We believe that addressing the current imbalance between these requirements and investor protection on the one hand and workability and competitiveness on the other will have a significant positive impact for smaller companies and the UK economy as a whole.

We have developed a proposal for the creation of a domestic securities offering regime, which seeks to reduce the costs of entry to our domestic public markets for companies and facilitate the participation of retail investors in initial and secondary equity issues.

Companies which use the new disclosure regime would be able to offer securities directly to the public through an offering document without the need to marshal the considerable resources and accommodate the extended timetable required for the production of a vetted and approved prospectus under the Prospectus Regulation. The Offering Document would operate alongside, and as an alternative to, the Prospectus Regulation.

This Offering Document could be made available as a means to IPO and raise further funds for companies on AIM, AQSE and the new Nasdaq-like segment. It would not be required to be pre-vetted provided that an adviser took responsibility for ensuring that all aspects had been addressed (further information on the role of the adviser can be found in our answer to Q4.3).

The adoption of the domestic securities offering regime would promote and facilitate the use of public offers across all these market segments and increase the number of retail investors holding shares in companies, with benefits for liquidity and price formation. This will markedly increase the attraction of the UK's markets.

We have sent our full proposal to you separately as part of our response. This was submitted to the FCA in August and it is currently under discussion. Please note that this proposal was developed before the review was announced and does not reflect the creation of a new Nasdaq-like regulated market.

Q4.2 How might current prospectus requirements be changed to better reflect the UK markets and the types of issuers listed on them?

As stated above, we propose a complementary offering document, suitable for the AIM, AQSE and the Nasdaq-like segment.

The thresholds that dictate when a prospectus is required to be produced are a significant obstacle, for example, when raising funds over €8 million, or if securities are offered to more than 150 non-qualified investors.

For many years the QCA has championed raising the threshold from €8 million to even £50 million, which is considered to be better calibrated to the UK market because the UK has, uniquely, financial promotion rules to protect investors in addition to those required by EU law. The €8 million level is an EU compromise amongst 28 different markets.

Similarly, the requirement to produce a prospectus if securities are offered to more than 150 non-qualified investors is artificial and overly restrictive. This rule is especially restrictive for smaller companies, where a larger percentage of their investors are from the retail community. In light of this, we would suggest removing increasing the threshold of 150 non-qualified investors entirely and instead allow any number of investors to invest subject to a requirement that they can certify that they have sufficient knowledge and aptitude to invest in certain stocks. Existing shareholders should be excluded from any calculation.

Whilst these changes may seem significant, it is fundamentally important that they are meaningful, so as to have a worthwhile impact.

There should also be no need to produce a prospectus when a company is conducting a secondary fundraising, including a rights issue or where the company's share capital has increased by less than 20% in any 12-month period. There should be a confirmation that all the necessary information is in the market unless otherwise disclosed in the announcement of the fundraising.

Q4.3 Should the loss of disclosure or liability attached to a prospectus document be replaced by any alternative measures if the general exemptions to a prospectus are widened?

We believe that the existing legal protections associated with offering documents, including the financial promotion regime and the civil and criminal offences created by the Financial Services and Markets Act 2000 as well as established common law, would continue to provide adequate protection if the general exemptions to a prospectus are widened. However, where an alternative form of offering document is used there can be no objection to the introduction of a parallel compensation regime for persons investing where there is negligent misstatement in such document as was the case for securities offerings made under the Public Offers of Securities Regulations 1995. This regime would serve to provide investors with direct redress for inaccurate and misleading statements within the alternative offering document. This would ensure that investor protection is not compromised.

We would refer you to our proposal for a new domestic securities offering regime for small and mid-sized quoted companies on the UK markets referred to in our response to question 4.1. The adoption of a direct compensation regime is an integral part of that proposal.

Dual and Secondary Listings

Q5.1 Are the UK requirements around dual and secondary listing a barrier to dual listing in the UK? If so, what could be changed to further encourage dual and secondary listings here?

Yes – we believe that the UK requirements around dual and secondary listing are a barrier to dual listing, as companies who have a dual or secondary listing have to comply with the listing requirements of both markets. The potential cost of complying with two sets of regulatory requirements in different jurisdictions may prevent them from seeking a secondary listing. In particular, the high standards of the Premium Listing segment could be acting as a deterrent to companies from other jurisdictions seeking a listing in the UK.

However, the issue with reducing requirements could result in less information being provided, which lowers governance standards and makes it incompatible with the level of risk mitigation factors associated with a Premium Listing.

For this reason, and in order for the UK to cement its place as a global financial centre, particularly in a post-Brexit era, a reappraisal in the requirements around dual and secondary listing would be appropriate for the new Nasdaq-like segment. It is imperative that the UK is seen as having an open environment for companies seeking to raise capital and this will improve the attractiveness of UK markets for companies by giving them greater choice and flexibility, whilst maintaining the integrity of the Premium Listing segment.

Other Issues

Q6.1 Are there any other immediate issues the review should consider?

The governance of the UK's public markets should be addressed

The review should consider the context in which change is made. As we have noted above, UK public equity markets have become increasingly unattractive. Merely changing a few rules will make no difference to whether the majority of the cohort of companies seeking finance over the next 10 years

will consider a listing as an obvious route. It may make a difference at the margin for one or two companies, but not for the mainstream.

Therefore, market operators, investors, and policy makers (and relevant associations) should be required to establish a public market oversight group to ensure that promotion of the UK's markets generally is adequately funded and executed.

No one organisation owns this product so all who contribute and benefit from the product should join together to ensure that the product is compelling, fit for purpose and well promoted to its target audience. The governance and operation of the UK public market business model needs to be agreed and managed effectively. Market failure can be identified when the UK markets are considered holistically and this requires short-term, limited but effective intervention.

One size corporate governance in the Premium Listing segment is disproportionate

The UK Corporate Governance Code adopts a one-size-fits-all approach to governance. For the largest companies, the UK Code is fit for purpose and holds them to account. There are very few dispensations for the smaller companies on the Premium Listing segment, so these companies either have to incur undue time and cost in compliance or spend time explaining why they have not complied (which is then ignored by the proxy voting advisers anyway). A proportionate governance regime for smaller companies on the regulated markets should be introduced, either in the Premium Listing segment, or preferably, in the new market.

Proxy voting advisers should be required to operate under a UK-specific code of conduct

One of the biggest complaints received from small and mid-sized companies during the AGM season relates to the behaviour of proxy voting advisers.

Companies are frustrated by the lack of access that they have to set matters right when such firms have made mistakes or misjudgements. In most cases these firms adopt a box-ticking approach that is completely at odds with the comply or explain or principles-based approach upon which both the UK Code and the QCA Corporate Governance Code is founded. Explanations that have previously been accepted by investors are ignored. Whilst there is a general Best Practice Principles for Shareholder Voting Research[9] adopted by proxy voting advisers, it is not specific to the UK market and therefore is not able to be enforced against proxy voting firms in a practical manner.

The impact of this should not be underestimated. The frustration of these companies adds to the feeling that the market and the approach of investors is not welcoming and is largely about policing and enforcement that is unaccountable and has little regard for the individual circumstances of a company. This adds considerable weight to the argument that the regulatory burden is unacceptable and results in companies telling us they would rather be private than public. This is broken and needs to be fixed.

[9] Best Practice Principles Group, 2019, Best Practice Principles for Shareholder Voting Research, available at: https://bppgrp.info/wp-content/uploads/2019/07/2019-Best-Practice-Principles-for-Shareholder-Voting-Research-Analysis.pdf

We recommend that a UK-specific code of conduct be required for proxy voting advisers, enforced by the FCA or the Financial Reporting Council/Audit, Reporting and Governance Authority.

The importance of retail investors

As this call for evidence is focussed on encouraging deeper capital markets, it is essential that the principles of maximising corporate access to capital and extolling the virtues of permanent public equity are matched by maximising access to a diverse range of investors.

Retail investors represent a major source of untapped capital[10] and the importance of these investors in providing liquidity should not be underestimated. The public equity markets provide a conduit for the distribution of wealth across society and the ability for a wider population to benefit from wealth creation (many investors compared with one investor in private equity).

AIM and the AQSE (formerly NEX Exchange) utilise retail investors to a much greater degree than the Main Market, with nearly a third of AIM shares and nearly 9 in 10 AQSE shares being owned by retail investors[11]. The new market could build on this by requiring all companies to have some form of retail offering to ensure that such investors can participate in IPOs and secondary fundraisings as a matter of course.

The lack of investment research

We believe that, since its introduction in 2018, MiFID II has had a detrimental impact on small and mid-sized quoted companies. Most significantly, MiFID II has:

- Heightened the lack of availability of research on SMQCs, both in terms of reducing the quantity and quality of research produced;
- Limited SMQC visibility, which has inhibited price discovery and reduced trading in their shares;
- Potentially contributed to greater share price volatility and higher-bid offer spreads;
- Led many to believe that it is the reason for the reduced number of brokers participating in the small-cap segment of the market;
- Impeded engagement between brokers and investors;
- Increased costs associated with raising finance coupled with a lack of institutional and retail investor appetite for the financial instruments of SMQCs; and
- Arguably had an adverse impact on liquidity within SMQC securities.

The QCA/Peel Hunt *Mid and Small Cap Survey*[12] demonstrates this. The percentage of investors that believe that MiFID II has had a negative impact on liquidity for small and mid-cap stocks has grown from 54% in 2017, to 63% in 2018, to 79% in 2019.

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[10] The Economist and PrimaryBid, 2020, Untapped Capital: Understanding the retail investor pool, available at: https://primarybid.com/whitepaper/understanding-retail-investor-pool

[11] Hardman & Co. & Argus Vickers, January 2020, Share Ownership: For the many, not the few?, available at: https://www.hardmanandco.com/share-ownership-for-the-many-not-the-few/

[12] QCA/Peel Hunt, February 2020, Mid and Small-Cap Survey, available at: https://www.theqca.com/article_assets/articledir_395/197511/To_Be_or_Not_To_Be_QCA_PeelHunt_Survey_Booklet_2020.pdf

The survey, which took soundings from 110 small and mid-sized quoted companies and 155 UK-based fund managers, also found that:

- 54% of small and mid-cap companies experienced a decrease in the amount of research produced on their company under MiFID II;
- 82% of UK fund managers saw less research being produced on mid and small-caps as a result of MiFID II;
- 70% believed that MiFID II had had a negative impact on small and mid-cap liquidity;
- 89% of investors and 90% of companies believe that there will be fewer brokers in the next three years; and
- 99% of companies believe that MiFID II will be part of the cause of fewer brokers.

As a result of the above, we believe that UK legislation, as we withdraw from the EU, should be amended to exempt small and mid-sized quoted companies from certain aspects of the regulation to make it more proportionate and not be a deterrent to companies of varying sizes using the UK's capital markets effectively. The current COVID-19 pandemic and the UK's withdrawal from the EU make it even more important to alleviate unnecessary burdens, increase visibility and provide liquidity opportunities for UK PLC.

In light of this, we specifically propose that small and mid-sized quoted companies should be exempted from the unbundling rules in MiFID II. When research is exclusively on small and mid-cap issuers, investment firms should be able to choose not to apply the current requirement to set up a research payment account or pay for research with its own resources. This should be available to small and mid-cap issuers who do not exceed a market capitalisation threshold of £1 billion. The opportunity to be able to bundle as well as unbundle will increase choice and allow brokers and fund managers to adopt a variety of acceptable business models.

Furthermore, we would also propose a review of the Financial Promotion rules that currently inhibit the distribution of small and mid-cap research so as to allow research to be distributed to a wider group of investors, subject to the incorporation of appropriate safeguards.

In addition, we would like to make the following comments:

1. It is not only the receipt of research that has been impacted as a result of MiFID II. It has also impeded broker engagement with companies and investors in restricting a brokers' ability to organise company meetings and for an investor to speak to an analyst about a company or piece of research. These conversations already take place within a regulated environment, covered by MAR, other MiFID II and FCA rules, and should not be dependent on having a research agreement.

2. Whilst changes to the rules may help increase the availability and distribution of research, we believe that the impact of such changes is unlikely to be significant since brokers will continue to be reluctant to cover companies (in particular many SMEs) where there is little commercial benefit in doing so. As a result, such companies may have to direct their focus on issuer paid (sponsored) research. We believe that the quality and therefore status of that research could be significantly improved by the establishment by the regulator of a code of conduct for issuer-paid (sponsored) research, whether it be by a broker or sponsored house. The

requirement to comply with such a code would increase confidence in issuer paid research and thereby make it more effective.

3. The retail investment community is of paramount importance to SME companies. The key issue that brokers have is that distribution of their research is restricted to a limited class of investors, and it is difficult for brokers to engage with retail investors who are key to liquidity in SME stocks. The issue is compounded by the fact that, where a broker is charging institutions for its research, it is difficult to justify that charge if the research is also being distributed free of charge to retail investors. Any solution will need to accommodate this, and other commercial issues presented by the current rules.

Tax treatment

We would suggest that proportionate tax incentives are introduced to kickstart the new Nasdaq-like market. We would be happy to have further discussions on this in due course.

Looking at public equity markets as a whole, it is generally accepted that there is a need to address the preferential treatment of debt over equity as a source of finance for companies.

Whilst, in recent years there have been legislative developments that have reduced the extent to which the corporate tax system encourages companies to raise debt finance over equity finance, there have been no corporate tax developments which have positively encouraged companies to raise equity finance. This has resulted in a significant and unwarranted corporate tax advantage in raising debt finance over equity finance. In particular, it is noted that companies can generally claim corporation tax relief for costs incurred when raising debt finance but are unable to do so for equity. This has a particular relevance to the comparative advantage that private equity holds over public equity.

Recent research by Link Asset Services illustrates that the debt of listed UK companies has risen to a record £390.7 billion[13] after nearly a decade of ultra-low interest rates. Any changes in the UK's economic fortunes could mean a significant number of companies facing serious financial pressures, which will substantially impact their ability to create jobs.

An international consensus has emerged, which supports the view that an imbalance in the tax treatment of debt and equity contributes to economic instability and hinders economic growth:

- The OECD found that more debt is typically associated with slower growth while more stock market financing generates a positive growth effect[14].
- The IMF's analysis has also shown that "the risks to macroeconomic stability posed by excessive private leverage are significantly amplified by tax distortions"[15].

[13] UK plc Debt Monitor (July 2018): https://www.linkassetservices.com/file.axd?pointerid=5b3a1ace8bcbe7006810403b

[14] OECD Economic Policy Paper, June 2015, No 14, available at: https://www.oecd-ilibrary.org/economics/finance-and-inclusive-growth_5js06pbhf28s-en

[15] 'Tax Policy, Leverage and Macroeconomic Stability', the IMF (2016), available at: http://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Tax-Policy-Leverage-and-Macroeconomic-Stability-PP5073

- TheCityUK and King & Wood Mallesons review of the listing's regime indicated that making equity issuance costs deductible for corporation tax purposes would promote greater long-term stability and incentivise greater use of capital markets[16].
- In its Capital Markets Union Action Plan[17], the European Commission stated its commitment to addressing the preferential tax treatment of debt in an effort to encourage more equity investments and increase financial stability in the European Union.

It is therefore apparent that reliance on debt finance is not a long-term solution for small and mid-sized companies. Accordingly, the UK government should take steps to eliminate the debt bias and incentivise equity finance as a source of long-term, patient capital.

We consider that the UK Government should begin to address the issue by providing tax relief for the costs of raising equity up to a threshold level. This would encourage a greater number of smaller companies to consider using public equity markets to finance their growth and development.

Fully leveraging the true potential of capital markets will ensure that small and mid-sized quoted companies – which play a crucial role in the UK economy – are able to raise capital more cheaply and efficiently in a way that will generate employment and wealth, drive sustainable economic growth and support wider financial stability.

We propose that the tax relief for equity raising costs referred to above should:

1. be subject to a £1.5 million upper limit in order to target the relief appropriately to smaller companies;
2. be applicable to both IPO and secondary fundraisings;
3. be available to the extent that the equity finance supports business activities; and
4. apply to all types of fundraising costs associated with raising equity to be deductible.

Finally, we believe that changes should be made to the risk capital schemes, namely, Venture Capital Trusts (VCTs) and the Enterprise Investment Scheme (EIS) in order to help small and mid-sized companies grow by attracting investment.

EIS and VCT provide smaller companies in their early stages with the crucial investment that allows them to grow and develop. Typically, these companies will struggle to attract the necessary investment due to their higher risk of loss of capital and lower liquidity. EIS and VCT help to ameliorate the funding limitations and improve the demand for shares in these companies. This is achieved through the provision of tax reliefs which encourage investors to invest by compensating them for the added risk. These investments are hugely important for investee companies who are seeking to improve working capital or cash flow and develop new products or services.

However, there are some issues with EIS and VCT which limit their effectiveness. These are:

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[16] Capital Markets for Growing Companies – A review of the European listings regime, TheCityUK, King & Wood Mallesons, available at: https://www.thecityuk.com/assets/2015/Reports-PDF/ELR-Capital-Markets-for-Growing-Companies.pdf

[17] European Commission Action Plan on Building a Capital Markets Union, available at: http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf

- HMRC delays – there are lengthy delays in HMRC's processing of investment applications, which prevent the effective delivery of finance to smaller companies, potentially causing them to lose out on crucial investments.
- The 7-year rule – the issues with this rule are particularly pronounced for acquisitive companies or companies that have separate divisions. The rule dictates that a newly/recently established division of a company may be eligible for EIS/VCT, but because the company operates under one corporate entity and has another division that made its first commercial sale more than 7 years ago, it will not be eligible. Similarly, there is a possibility that an EIS/VCT eligible company that is still within the 7-year rule will undertake an acquisition of a non-eligible EIS/VCT company outside of the 7-year rule making it ineligible for the schemes.
- Funding gap - once a company exceeds the thresholds making them ineligible for EIS/VCT investments, the company will likely find itself unable to attract investment because they are still too small and too high risk. There is evidence of companies increasing their market capitalisation and displaying impressive share price performance as a result of EIS/VCT and then being unable to locate investment once outside of the eligibility criteria.

In order to correct these issues, we propose some potential solutions/improvements:

- Streamlining of the processing/eligibility criteria – a streamlining of the processes would help to reduce the extent to which the delays can hinder, or even stop, the IPO and/or secondary fundraise process. In order to address this, HMRC should encourage companies to self-approve investments on the basis of professional advice. In order to ensure that the self-approval system is efficient, with the removal of subjectivity and inconsistencies in the application of the rules, HMRC needs to provide greater clarification and make the system more transparent.
- Reconfiguring the 7-year rule – firstly, we propose that there needs to greater flexibility on the rule, with a revision back to the pre-2015 rules on acquisition finance. That is, to allow the EIS/VCT tax breaks for acquisition financing, so long as the combined entities are below the specified size and the spirit of the combined entity remains entrepreneurial and/or knowledge intensive. Secondly, we propose that the Government and HMRC consider amending the 7-year rule and, instead, determine a company's maturity by using alternative metrics that are less artificial.
- Addressing the funding gap – in order to reflect the maturing of the market and growth company eco-system, we urge the Government, at a minimum, to periodically assess the qualifying limits. However, we also urge the Government to update the current limits in gross assets and number of employees in order to address the funding gap.

Liquidity

In UK markets, small and mid-sized quoted company stocks have suffered from a lack of liquidity for a combination of reasons. However, the overwhelming view is that liquidity in these stocks has been further reducing in recent years, with the Woodford Equity Income Fund debacle in 2019 making the situation considerably worse.

The concerns over liquidity in the small-cap space has resulted in an alarmist situation amongst the clients of UK fund managers, which has had the effect of greatly reducing the support for micro/small

caps. A consequence of this is the increase in size of the smallest company that a small-cap fund manager would consider when looking to add a new position to a portfolio. This has resulted in examples of companies shifting planned IPOs from London to overseas markets where funding was perceived to be more readily available, or favouring private equity as an alternative capital provider.

A consequence of the issues highlighted by the Woodford debacle has been that internal and external compliance, risk and control functions have become much more focussed on liquidity. This overly cautious approach has been forcing investors as a whole to reduce exposure to less liquid stocks.

In addition to this, the FCA has issued, on a piecemeal basis, letters to Authorised Fund Managers in relation to good practices for effective liquidity management[18]. This letter was perceived by recipients to be generally unhelpful due to its apparent one-size-fits-all approach and its design which seemingly intends to deflect blame from the regulator in the event of further liquidity issues in open-ended funds, as well as not providing any clear guidance to fund managers on what was appropriate specifically in relation to smaller listed growth stocks. This lack of clarity has resulted in an increasing tendency amongst fund managers to act with increasing caution.

As a result of the above, we would like to put forward certain high-level proposals/solutions that would help to counter the liquidity issues raised. Namely, that:

- The FCA clarifies its intentions and position on less liquid stocks;
- Tax breaks are extended to encourage investment in small-cap stocks; and
- The regulation of smaller quoted companies should be proportionate and not one-size-fits-all.

Cost-benefit analysis to the pre-vetting process for prospectuses

The current pre-vetting process for prospectuses forces companies to have to accommodate an extended timetable for the production of a vetted and approved prospectus under the Prospectus Regulation at a time when a company is attempting to raise capital, which often needs to be done quickly. The pre-vetting process lengthens this process significantly, making it incredibly difficult for companies to gain access to capital in a timely manner and adds to the overall costs of producing a prospectus. The cost and time it takes to produce an approved prospectus acts as a significant disincentive for companies considering accessing public markets in the UK. Many companies will consider the costs and burdens of this to be disproportionate to the money they are able to raise and will resort to exploring quicker and simpler means to gain access to capital.

For this reason, our proposal for a domestic securities offering regime suggests moving away from the pre-vetting process for companies which are eligible to use the new form of offering document. The process would be replaced by a regime which provides for mandatory oversight by a “Reporting Adviser”. Specifically, the Reporting Adviser would fulfil a similar role to that fulfilled by the Nominated Adviser on the admission of securities to AIM. Specifically, The Reporting Adviser would be required to review the steps followed by the issuer and its advisers in the preparation of the document and to complete and deliver to the FCA a report confirming its view that due process has been followed in the preparation of the offering document (the Due Process Report). Guidance as to what constitutes

[18] Nick Miller, Head of Asset Management, FCA, Letter on Effective liquidity management: good practice for Authorised Fund Managers, 04 November 2019

"due process" could be provided within the legislation implementing the new Domestic Offers Regime. The Relevant Adviser would be subject to potential sanctions if it does not exercise due skill and care in the issue of the Due Process Report.

Whilst we firmly believe that there are significant benefits to the market in adopting the Reporting Adviser proposal set out in our paper, we also consider that it is imperative that a cost-benefit analysis of the pre-vetting process for prospectuses is conducted in any event. Such a review is likely to confirm our view that for the small and mid-cap community, the time and expense inherent in pre-vetting is disproportionate to the benefits it delivers and, in the case of larger companies and issuances it will assist in establishing the circumstances in which pre-vetting might be considered to add meaningful value to equity offerings.

If, in conducting the analysis, it is apparent that a situation has arisen whereby the value gained by pre-vetting a prospectus is outweighed by the additional burden placed on companies, we believe that the pre-vetting process should be discontinued.

Q6.2 Are there any non-regulatory, non-legislative actions that could the UK take to promote the use of public equity markets?

As described throughout our response, we believe that there is an opportunity to use the Standard Listing platform as an opportunity to create a new, vibrant, and attractive mid-tier market. This will require serious and committed investment of enthusiasm, resource and promotion to make this successful. Separate governance structures to create and maintain differentiation between the SME Growth Markets, the Nasdaq-equivalent and the NYSE equivalent needs to be carefully considered.

In addition to this, we believe that it is fundamentally important to make public markets a welcoming environment for companies and investors. We stress that any rule changes implemented must be complemented and supported by an ongoing cultural change towards encouraging public equity. Whilst rule changes can help support the market, it is the underpinning culture of these markets that will have the greatest influence on enacting behavioural change and fostering deeper and more affluent markets. For this reason, we urge the review and HM Government to bear this in mind when taking forward any proposals.

Conclusion

The UK's equity markets are arguably not fit for the future nor fit for the present in serving the needs of companies and investors. Radical change is necessary, and we believe there is a gap in the UK's offering. A mid-tier Nasdaq-like market is necessary in order to complement the UK's highly successful SME Growth Markets and the less successful Standard Listing segment.

Action is needed now.

Appendix 1

We are the Quoted Companies Alliance, the independent membership organisation that champions the interests of small to mid-sized quoted companies.

The value of our members to the UK economy is vast – as is their potential. There are around 1,250 small and mid-sized quoted companies in the UK, representing 93% of all quoted companies. They employ approximately 3 million people, representing 11% of private sector employment in the UK, and contribute over £26bn in annual taxes[19].

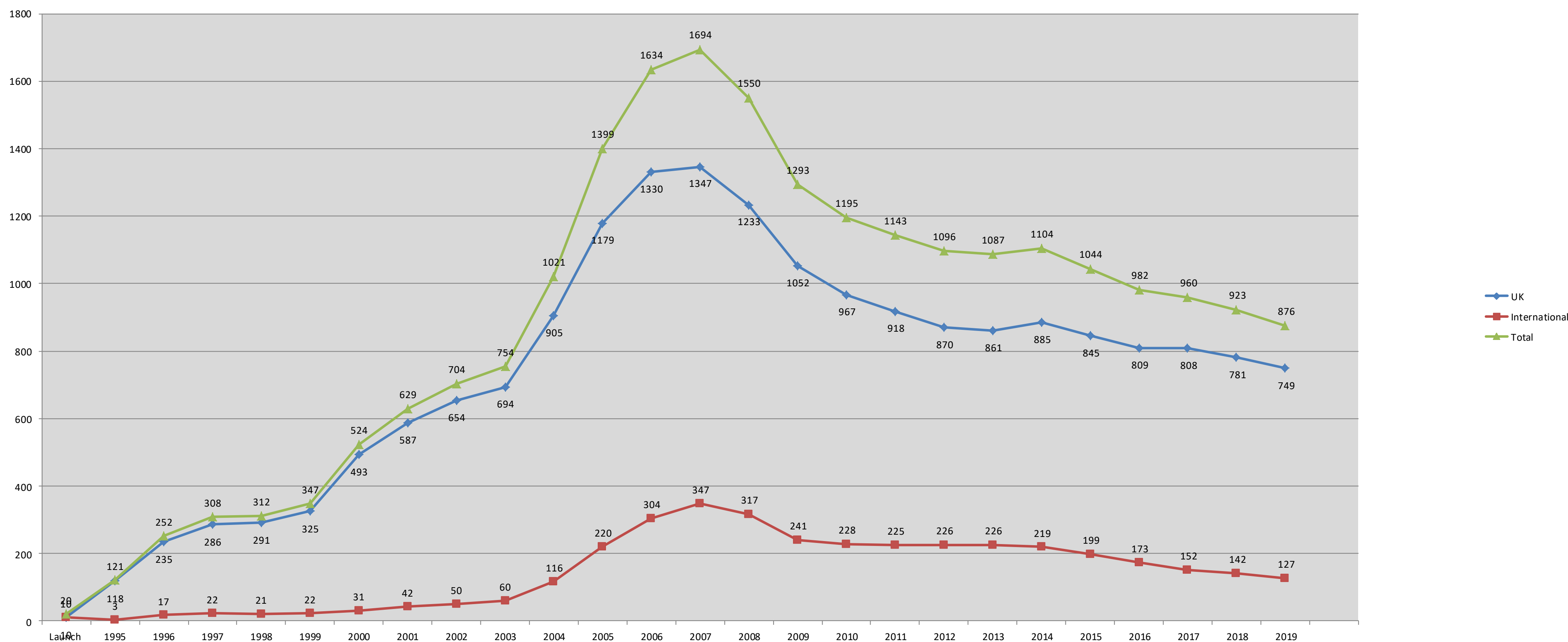
Our goal is to create an environment where that potential is fulfilled.

We identify the issues that matter to our members. We keep them informed. And we interact to build the understanding and connections that help our members stay ahead.

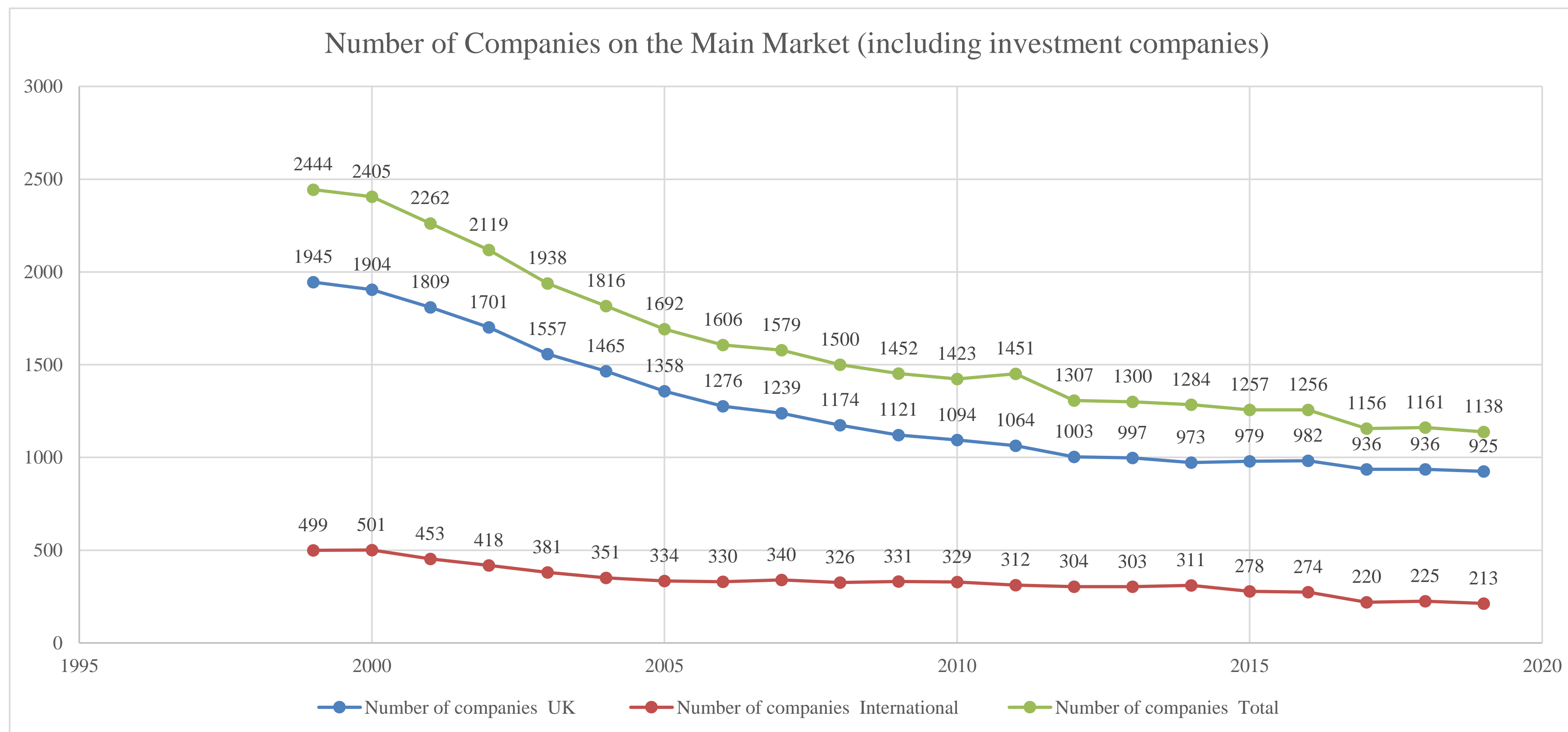
The influence we have, the influence we use, and the influence we grow, ensures that our members always benefit from the impact of our initiatives.

[19] Hardman & CO. and the QCA, May 2019, How small and mid-cap quoted companies make a substantial contribution to markets, employment and tax revenues, available at: https://www.hardmanandco.com/wp-content/uploads/2019/05/How-small-and-mid-cap-quoted-companies-make-a-substantial-contribution-to-markets-employment-and-tax-revenues.pdf

Appendix 2

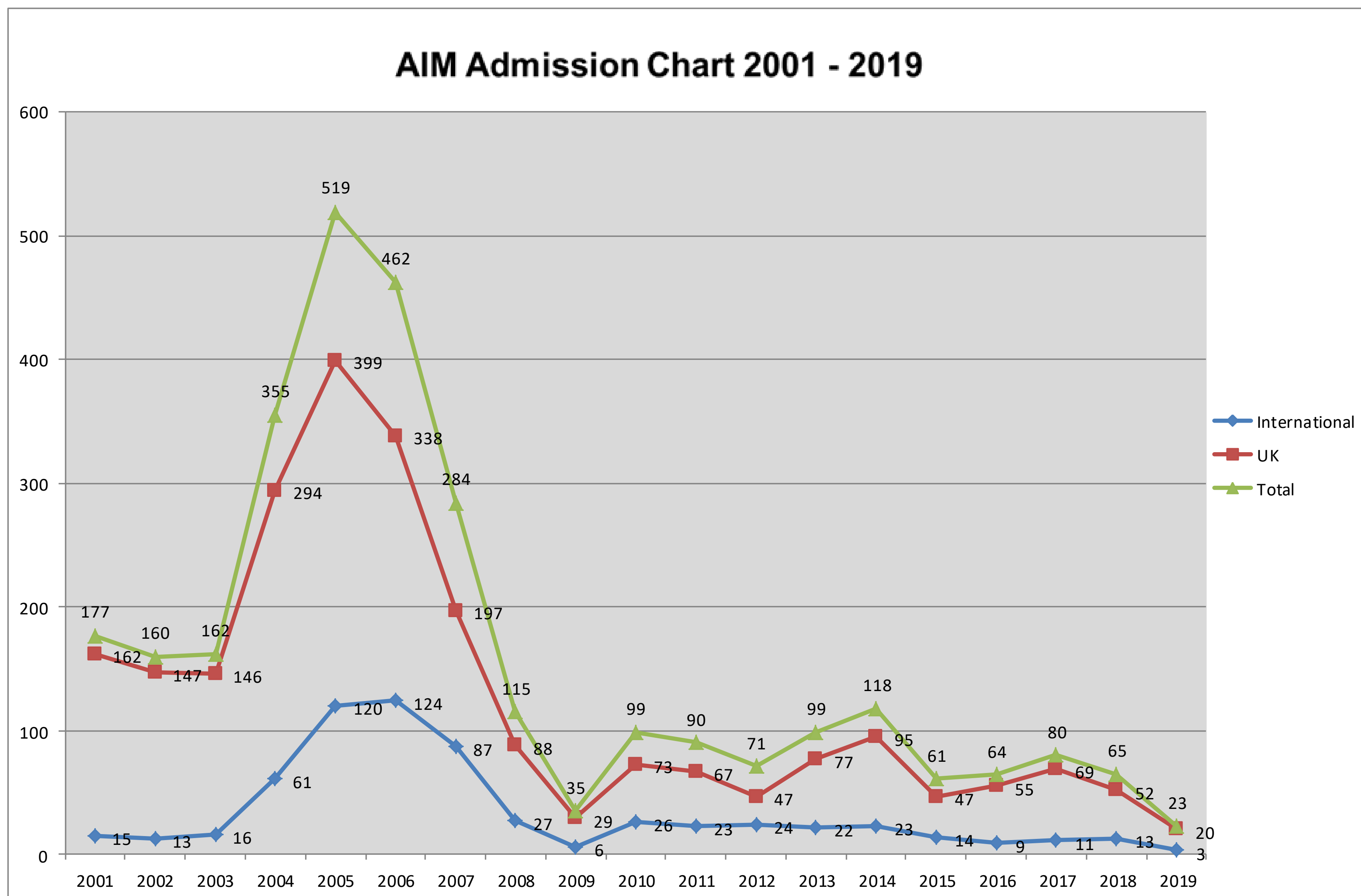


Appendix 3[20]



[20] Please note that these figures are gross and should be reduced by the number of investment companies that currently populate the market. Excluding these investment companies, the number of companies quoted on the Main Market has fallen by 60% since 1999. This compares with a 52% decline when financials are included. Furthermore, when looking below the largest 350 companies, the number of non-financial companies on the Main Market has fallen by 72% since 1999. By December 2019, the number had fallen to just 252. Further information can be found in a report by Hardman & Co. and the QCA here: https://www.theqca.com/article_assets/articledir_404/202121/Hardman-Insight-Are-public-market-closing-to-smaller-companies-May-2020.pdf

Appendix 4



QUOTED COMPANIES ALLIANCE

Appendix 5