QUOTED COMPANIES ALLIANCE

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Dear Sirs,

European Commission Green Paper – Building a Capital Markets Union

Introduction

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

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

The Quoted Companies Alliance Expert Groups have examined your proposals and advised on this response.

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

Response

We welcome the opportunity to respond to this consultation. We have welcomed the European Commission's efforts so far in taking account of SMEs' needs. 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. As such, we urge the Commission to develop a joined-up approach to reviewing SMEs' access to public equity finance.

We view SME access to finance as vital to encouraging economic growth and sustainable employment opportunities throughout Europe and we would welcome a strong, integrated European Union (EU) policy to support SMEs.

We have identified a number of regulatory and behavioural issues in public equity markets that make raising finance on these markets more difficult, less efficient and less effective for SMEs, especially when compared to other forms of finance available to them (i.e. bank debt, venture capital, private equity, etc).

The Quoted Companies Alliance is the independent membership organisation that
champions the interests of small to mid-size quoted companies.

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Some of these issues are caused by how market participants interpret regulations; some are caused by the current economic environment; and some are directly a result of how policymaking discourages SMEs from either seeking admission to a public equity market, raising finance on an equity market, and/or driving investment away from quoted SMEs.

We have identified issues below, outlined the problems and, wherever possible, highlighted possible policy solutions to alleviate these issues and, ultimately, make public equity markets more accessible for SMEs. Please note that we have only responded to the questions most likely to have an impact on small and mid-size quoted companies.

Responses to specific questions

Q1 Beyond the five priority areas identified for short term action, what other areas should be prioritised?

We welcome that the first priority for early action listed in the Capital Markets Union (CMU) Green Paper is a re-evaluation of the prospectus regime in order to lower the barriers to accessing capital markets and also how to boost the take-up of SME Growth Markets. In this regard, we support strongly the review of the prospectus regime being carried out by a specific public consultation, to which we have submitted a response.

We support other areas identified for short term action, particularly widening the investor base for quoted SMEs to build an efficient and sustainable capital market for quoted SMEs.

Notwithstanding this, we believe that there are other key points that should be added to the list of priorities for early action, as they are essential to ensuring the success of the Capital Markets Union initiative:

1. Assessing the regulatory landscape

The Commission should ensure that the regulatory framework being adopted and currently under discussion does not work against smaller issuers and the real economy. The Commission must ensure that this framework is aligned with the vision for the CMU in building a single market for capital. We are particularly concerned with the Level 2 measures on MiFID II, CSDr and MAR, particularly relating to investment research, delayed post trade reporting (liquidity) and SME Growth Markets[1]. The Commission must ensure consistency and consolidation of financial services regulation with the purpose of the CMU, paying particular attention to small and mid-size quoted companies. What is required is a primary markets action plan which puts companies' needs first.

In this regard, the Commission should conduct a thorough impact assessment on the interaction of the regulatory framework as a whole – including delegated acts and regulations – to ensure a coherent interplay of rules for a smooth functioning of the single market for finance. This is a vital assessment to identify what needs to be done towards developing and integrating capital markets, which should be designed to fuel the engines of growth, small and mid-size quoted companies.

[1] See our submissions at http://www.theqca.com/about-us/responses/.

The Commission should integrate legislative reviews more carefully, bearing in mind the specific costs and benefits for quoted SMEs, treating this segment as a separate asset class. We welcome the Commission's better regulation agenda as we encourage the simplification of regulation for quoted SMEs, not necessarily the creation of more regulation. Regulation should be appropriate and proportionate, not reduced.

We believe that companies should also be seen as consumers of the capital markets, and as such should benefit from adequate support and protection in policy and regulation that can encourage and enable their growth potential, stability and development.

The European Commission and Parliament must take coordinated and decisive action to create a truly proportionate regulatory regime for small and mid-size quoted companies.

2. Building on the ecosystem for SME Growth Markets

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

Companies find it difficult to access bank loans. In many cases, temporary bank finance is not an appropriate means to capitalise a business. As many businesses need to recapitalise, access to public equity markets for SMEs is paramount. This involves re-examining barriers to entry for obtaining a listing together with the ongoing requirements and ensuring that public equity markets for SMEs have a strong investor base and are liquid.

The introduction of SME Growth Markets is essential in ensuring that SMEs can access capital markets in the EU. The MiFID I framework currently classifies existing growth markets for smaller companies (exchange regulated markets, such as AIM and ISDX in the UK and Alternext in France) as multilateral trading facilities ('MTFs'). The primary market function deserves to be recognised and treated differently in order to facilitate access to capital by SMEs across Europe and we therefore support the European Commission's and Parliament's action in this area by the creation of the SME Growth Market category in MiFID II.

SME Growth Markets should be able to operate through the application of a number of different models. Harmonisation in this area must take into account the need for SME Growth Markets to retain flexibility as to the specific market model and eligibility criteria. It is important to highlight that harmonisation should not mean homogenisation: no one model will work for all European markets, as they all have different investment cultures. A level of flexibility must be retained at a Member State and market operator level to account for different local and market practices. This would not hinder the creation of pan-European standards, common to all SME Growth Markets across the European Union, where companies choose to access new finance outside their local market.

SME Growth Markets are not regulated markets and to regulate them as such would remove the flexibility needed for them to provide a platform for SMEs to grow and create employment throughout the EU. Developing a pan-European market concept within a local market framework – with minimum levels of pan-European regulation which is required only for those companies choosing to access investors outside

their local market – would incentivise companies and investors to look beyond their Member State boundaries as they grow.

This approach is in line with the goal of SME Growth Markets, as set out in the level 1 text: facilitating access to capital for SMEs and the development of specialist markets that aim to cater for the needs of SME issuers, while bearing in mind the lessening of administrative burdens for issuers.

As companies grow, issuers could have the choice to move from using national accounting standards for local companies to adopt a common set of accounting standards as they access pan-European markets. This would allow for cross-border access to equity (e.g. passporting) and facilitate investment. It is key that different types of companies can have different access points, and can develop within the ecosystem on a graduated basis. As companies access Member States other than their own, the need for comparability increases. We believe that a graduated approach will prove to be more attractive for companies in their decision to join public markets. This will support the growth objective of the CMU.

3. Creating an SME Asset Class

There is no single legal definition of a small and mid-size quoted company in the EU. A single definition, or asset class, is needed so that European regulations can be focused and proportionate.

Small and mid-size quoted companies are fundamentally different from large blue chip companies - in terms of their growth potential, size, turnover, market capitalisation, job creation, percentage shareholding of investors, types of investors, etc. As such, they require a different regulatory and market ecosystem.

As there is no one single definition, we are seeing a proliferation of definitions throughout various pieces of legislation, especially with regard to the European financial services directives. This is damaging and adds additional complexity for all market participants.

SME policy initiatives should not be restricted to SME Growth Markets as there are a significant number of smaller listed companies on regulated markets. For instance, out of 921 UK Listed companies on the UK Main Market, 228 (or 25%) have a market capitalisation below £100 million (the definition of SME Growth Markets is benchmarked at companies with a market capitalisation of €200 million).

The US's Jumpstart Our Business Startups (JOBS) Act aims to ease the initial public offering process and reporting requirements for growth companies. Section 101 of the Act defines an emerging growth company as a company with annual gross revenues of less than $1 000 000 000 during its most recent fiscal year as shown on the income statement presented under US GAAP. This is a much higher size threshold than any EU legislation provides for.

In Weild, Kim and Newport's report looking at US equity markets (September 2012), a small cap company is defined as a company with a market capitalisation between $500m and $2bn.[2]

[2] Weild, David, Edward Kim and Lisa Newport. The trouble with small tick sizes: Larger tick sizes will bring back capital formation, jobs and investor confidence. Grant Thornton Capital Market Series. September 2012: http://www.gt.com/staticfiles/GTCom/Public%20companies%20and%20capital%20markets/Trouble_Small_Ticks.pdf

If equity markets in the European Union are to remain internationally and domestically competitive in terms of attracting small, growth businesses, they need to provide a viable regulatory and listing regime similar to that provided in the US JOBS Act but designed to meet the needs of the EU.

We recognise that one size does not fit all. A suitable definition of small and mid-size quoted company will vary for each Member State. We need to have a single market for finance that flexes for the different types of market that are part of it and the companies that want to join the markets.

Therefore, the Commission should evaluate the creation of a SME Asset Class, so that Commissioners, policymakers, regulators and market operators can easily facilitate proportionate and appropriate policy for growing companies, and so that investors can more easily allocate funds to these companies. We believe that this definition should comprise all quoted companies with market cap below 500m EUR (being the lower level described in Weild, Kim and Newport's report mentioned above). If Member States wished to set a figure below this to suit their market they should be able to do so.

4. Designing appropriate indices

The Commission should encourage major European and national indices to be constructed and reflect more more accurately the constituents' contribution to Member States' economies and the European economy as a whole. Current indices are weighted by market capitalisation in favour of ex-growth global companies.

We further analyse this in our response to Q5.

5. Secondary Market Pilot Schemes

The Commission should examine whether there are areas within the secondary markets which could be changed to improve liquidity in small and mid-size company shares. This could include experimenting and assessing different tick sizes, trade reporting requirements and pooling annual reports and research.

We believe that there is an urgent need for the European Commission to have a joined up policy for helping small and mid-size quoted companies raise money through primary equity markets. We believe that the European Commission should create a working group to conduct a review to determine whether European primary equity markets are fit for purpose – in helping small and mid-size quoted companies grow and create employment. This review could explore:

- what changes to EU regulation and what EU initiatives could help deliver a better environment for small and mid-size quoted companies to raise equity on a primary equity market;
- the creation of a SME Asset Class, so that Commissioners, policymakers, regulators and market operators can easily facilitate proportionate and appropriate policy for growing companies, and so that investors can more easily allocate funds to these companies;
- the possibility of introducing minimum quoting and trading increments (tick sizes) for stocks of smaller companies along the lines recently announced by the SEC;
- ensure that major European and national indices are constructed and calculated in a way that more accurately reflects constituents and their contribution to Member States' economies and the EU economy as a whole;
- what incentives and support investors – both institutional and private – have to invest their money in growing companies; and

- developing ways to pool company reports and accounts as well as research to make it more widely available.

Q5 What further measures could help to increase access to funding and channelling of funds to those who need them?

We believe that there are important changes to the Prospectus Directive (which we have explained in detail in our response to the European Commission's consultation on the revision of the Prospectus Directive) which will significantly contribute to increasing access to funding and channelling of funds to those companies who need them.

In addition to those proposals, we have identified a number of regulatory and behavioural issues in public equity markets that make raising finance on these markets more difficult and less efficient and effective, particularly for SMEs, and proposed possible policy solutions to alleviate these issues and make public equity markets more accessible.

A. Lack of analyst research on quoted SMEs

There is less research available on small and mid-size quoted companies than that which is available for large blue chip companies, which hinders their ability to attract and retain investors. As pointed out in the Commission Staff Working Document accompanying the CMU Green Paper, "there is inadequate business information on SMEs that have a listing or seek a listing. One of the reasons is that equity research analysts and business information providers are far less likely to cover SMEs with their research than large companies."[3]

Forefactor, an independent market research organisation, conservatively estimates that 35-40% of all publicly traded companies worldwide have no sell-side analyst coverage and that small and micro cap companies suffer the most from this.[4]

In a recent survey published in 'Pulse', Issue 13 of the QCA/BDO Small and Mid-Cap Sentiment Index, we found that 21% of companies had not received any research output from their house broker over the last two years[5].

The key reasons that small and mid-size quoted companies do not attract as much coverage include:

- Large cap companies are more likely to generate higher investment banking fees;
- Typically, greater liquidity translates into higher revenue from trading commissions; and
- Many buy-side funds are bound by market cap restrictions in their investment mandates.

All of this indicates that there is less incentive from a broker perspective to provide coverage for small and mid-size quoted companies. They simply do not gain much from covering them.

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[3] See Commission Staff Working Document accompanying the Capital Markets Union Green Paper, available here http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015SC0013&from=EN.
[4] http://www.world-exchanges.org/insight/views/small-cap-analyst-coverage-under-radar-dilemma
[5] In 'Pulse', Issue 13 of the QCA/BDO Small and Mid-Cap Sentiment Index, available here: http://www.theqca.com/article_assets/articledir_171/85657/QCABDODPULSE_Issue13Final.pdf

Weild and Kim (2009) also note that high quality investment research has fallen significantly in the past five years and, as a result, smaller companies have disproportionately suffered from this 'brain drain'. Weild and Kim cite research from Integrity Research that estimates that 40% of sell-side analysts lost their jobs in 2008. They also cite research from FactSet Research Systems that shows that for an eight-and-a-half month period ended in May 2009, there were 2,200 incidents of analysts dropping coverage of a company. While Weild and Kim are looking at the US economy and equity markets, these findings resonate with the declining level of research across Europe.

In order to compensate for the lack of sell-side analyst coverage, small and mid-size quoted companies can turn to independent research providers. However, this is an added cost for the company, and so, the take-up of this has not been widespread.

A recent Peel Hunt and Extel Survey[6] found that 78% of quoted companies responding see a correlation between the number of analysts writing on their company and the liquidity of their shares. Small and mid-size quoted companies need more research coverage in order to retain current investors and attract new ones, which would stimulate increased liquidity in their shares. The introduction of minimum tick sizes could be one way to create the finance to fund such research coverage.

It is important where research exists to give more visibility to and raise awareness of its availability. Commercial initiatives to pool research output should be actively encouraged by the European Commission.

B. Indices

Some European markets' indices, such as the UK's national indices, are heavily weighted towards large global companies that are headquartered in Europe and do not necessarily reflect economic contribution to that economy. Therefore, passive investment funds, such as Exchange Traded Funds, are skewed to investing in these larger global companies regardless of economic impact.

For example, the top six companies by market capitalisation in the UK's FTSE All Share Index accounted for 31% of the index as at 30 April 2015. The total number of constituents was 642 companies at that date.

There are many "UK Funds" marketed to institutional and private investors which, as a result of the index methodology applied, do not actually demonstrate investment in UK-centric quoted businesses. This situation may be prevalent elsewhere in other Member States. More transparency over the shares in which a fund invests would help to overcome this. An SME Asset Class would greatly assist this.

By developing indices that are more focused on companies' contribution to Member States' economies, further liquidity should flow into these companies as new funds are launched and marketed. This is not just a UK problem but is a European-wide opportunity.

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[6] Unintended Consequences' November 2014, available here:
https://www.extelsurveys.com/Panel_Pages/PanelPagesBriefings.aspx?FileName=Peel_Hunt_Extel_Unintended_Consequences_November_2014

C. Raising the profile of public equity

A key issue preventing SMEs from accessing public equity is the lack of promotion of public equity as a viable form of finance, especially when compared to other financing options available to them.

There is no pervading positive culture towards equity finance as an option for SMEs from governments, media and society.

Over the last 10 years, the number of companies on equity markets in the EU has fallen. As pointed out in the IPO Task Force report, the number of IPOs in recent years is very modest, particularly for smaller companies. The report notes that according to the exchanges, "the main factor explaining the decline of number of IPOs is the decline of smaller companies coming to the market".[7]

Compounding this is a general and pronounced lack of confidence in equity markets. The QCA/BDO Small and MidCap Sentiment Index[8] asked whether equity markets are helping or hindering a company's development in the UK. Between 2011 and 2014 there has been a marked change in sentiment. In September 2011, only 14% of companies said that equity markets were helping their company's development. In April 2014, 58% of companies held that view. The improvement correlates with the improvement of the economic climate. More importantly however, there remains a significant minority that express the view that equity markets are hindering their development (12% in 2014).[9]

With the outlook for equity markets so low amongst existing market participants, it is not surprising that potential market participants are disheartened.

- Government and industry efforts to raise the profile of public equity

We believe that the European Commission, namely DG Growth and DG Fisma, should promote equity finance to SMEs through promoting increased education. Furthermore, the European Commission and Member States should explore whether there are aspects of the European tax system that unduly favour debt/private equity/venture capital finance in comparison to public equity.

We believe that, with the Capital Markets Union initiative, there is momentum to help SMEs to evaluate the financing option of public equity and also help them to determine whether they would benefit from accessing a public equity market. We would welcome and support the European Commission in producing practical guides for companies considering going public (such as the recently published 'Practical guide to going public', which we have supported the Commission in producing).

We are also supportive of the European Small and Mid-Cap Awards, which promotes best practices and success stories on public equity markets, underscores the diversity of European capital markets and promotes stock listings. We were supportive of the development of these awards and we would welcome the continued visible support of the Commission.

[7] Available here: http://www.europeanissuers.eu/_mdb/spotlight/44en_Final_report_IPO_Task_Force_20150323.pdf.
[8] Reports available here: http://bdoqcasentimentindex.co.uk/.
[9] See http://bdoqcasentimentindex.co.uk/downloads/QCA-BDO-Small-and-Mid-Cap-Sentiment-Index-May-2014.pdf.

We believe that fiscal and regulatory support to simplify the procedures to award shares and options to employees and to encourage employee ownership would also broaden the understanding of public equity and raise its profile.

D. Converting bank finance into equity

For many companies, particularly those of a size to consider an IPO, temporary bank finance is not the best way to fund the capital of a business. In the UK, five clearing banks have set aside a facility of £2.5bn to form the Business Growth Fund (BGF). With regional offices to contact companies, the fund invests in businesses with revenues between £5m-£100m, both privately owned and AIM-listed. This encourages companies to recapitalise in an efficient manner. These companies are further supported by the appointment of an experienced director to the board.

The Commission should explore a pan-European version of BGF. Banks could be encouraged to do so through assigning this capital favourably under solvency ratio rules. In this way the “European Business Growth Fund”, with a regional network, could accelerate a switch from reliance on temporary bank finance to permanent equity finance. It would also raise awareness of the importance and effectiveness of equity in generating growth, jobs and economic wealth throughout the European Union. The shift from debt to equity would improve the economy’s risk profile in any future downturn.

Q8 Is there value in developing a common EU level accounting standard for small and medium-sized companies listed on MTFs? Should such a standard become a feature of SME Growth Markets? If so, under which conditions?

We do not think that it would be helpful for the EU to adopt its own set of accounting standards for small and mid-size listed companies on MTFs. We believe that this could be counter-productive by adding complexity and decreasing comparability.

We consider that small companies on SME Growth Markets should have the choice to use local accounting standards, IFRS for SMEs or full IFRS, rather than having to use only full IFRS as at present. We note that the ESMA Markets and Securities Stakeholder Group has recommended that the use of full IFRS should be optional for SMEs[10].

Our members - small and mid-size quoted companies - do not believe that the adoption of IFRS has had a direct benefit on that cost of capital. We believe that this is supported by academic studies which seem to indicate that the reduction in the cost of capital through the introduction of IFRS is limited to the larger companies on the capital markets.

Many of our members are concerned about the increasing length of their annual reports and accounts as a function of increased disclosure both in the narrative and financial statements. We believe that this results in annual reports and accounts becoming less clear (thus potentially obscuring important information) and more full of standard 'boilerplate' disclosure, which does not tell the users/investors much about the company and its position.

[10] ESMA Securities and Markets Stakeholder Group – Report on Helping Small and Medium Sized Companies Access Funding, page 17: http://www.esma.europa.eu/system/files/2012-smsg-59.pdf.

Overall, we believe that both the EU, Member States and accounting standard setters need to take into consideration the combined effect of adding more disclosure to companies' annual report and accounts and evaluating whether the cost/benefit of any disclosure is appropriate, considering in particular whether adding disclosure will increase transparency or have the opposite effect of overloading the accounts and thus potentially obscuring important information.

Furthermore, we believe that the EU, Member States and accounting standard setters must recognise the difference in scale of, and of resources available to, small and mid-size quoted companies which may have a capitalisation of just a few million pounds compared to their global listed counterparts capitalised at many tens of billions of pounds. The European Commission should ensure that this issue is addressed appropriately by the IASB and consider whether changes should be made to the IAS Regulation to ease this burden.

The European Commission should also encourage more smaller listed company representation within the governance structures of EFRAG, IASB and other key institutions particularly ESMA. This will help these regulators to create proportionate rules at the right time. Any market impact assessment should specifically take into account the effect on small and mid-size quoted companies. An SME Asset Class would assist this.

Q10 What policy measures could incentivise institutional investors to raise and invest larger amounts and in a broader range of assets, in particular long-term projects, SMEs and innovative and high growth start-ups?

Please see our response to Q5.

Q13 Would the introduction of a standardised product, or removing the existing obstacles to cross-border access, strengthen the single market in pension provision?

We would agree with the introduction of a standardised product only if there is a required allocation to quoted SMEs. We believe that it is important to identify who is investing in the future of the European Union. For this reason, disclosure from pension funds which use a standard EU product should be required to disclose how much money is allocated to investing in the SME Asset Class. This would enable European citizens to make better choices about how to invest in Europe's economic future.

We believe that institutional investors play an important role in the provision of permanent equity capital, especially to small and mid-size quoted companies. For example, pension funds should be much more active in investing in small and mid-size quoted companies. Pension funds have been withdrawing from equities in recent years.[11]

Pension funds have increasingly been disincentivised from investing in small and mid-size quoted companies as a result of regulation. For example, the application of Solvency II to pension funds could mean that pension funds are less inclined to invest in SMEs as they are classed as risky investments. Making insurance companies and pension funds demonstrate solvency on a continuous basis inevitably turns them into short-term investors even though their liabilities are actually long-term.

[11] The UK Pensions Regulator has said that UK funds hold 43.2 per cent in gilts and fixed interest compared with 38.5 per cent in equities. This is the highest allocation of gilts and fixed interest since the Pensions Regulator started compiling data in 2006.

We believe that more can be done by Member States to incentivise institutional investors to invest in small and mid-size quoted companies. For example, the abolition of the dividend tax credit for pension funds in the UK in 1997 has resulted in the value of pensions being more uncertain and reliant only on the contributions of the employee and employer. At a time when governments are focused on encouraging people to save for their retirement and are faced with a pensions crisis, reinstating the dividend tax credit would be a welcomed action. We are recommending that the UK Government reinstate the dividend tax credit for investments by pension funds in SMEs.

We believe that it is important for policymakers to consider how prudential reforms can affect behaviour and put pressure on funds to focus on the short-term, which does not support patient investment in growth companies and SMEs.

Q15 How can the EU further develop private equity and venture capital as an alternative source of finance for the economy? In particular, what measures could boost the scale of venture capital funds and enhance the exit opportunities for venture capital investors?

The creation of vibrant public equity markets would greatly enhance exit opportunities for venture capital investors. Increasing allocations to small and mid-size quoted companies would contribute to this, as well as the creation of an SME Asset Class.

Q16 Are there impediments to increasing both bank and non-bank direct lending safely to companies that need finance?

We believe that the role of banks in providing long-term bank facilities to growing companies is already reduced and will continue to reduce over the next few years due to a number of factors, including changes to banking regulation. We believe that there needs to be a shift from relying on temporary bank debt finance to an ecosystem that builds on permanent equity capital. It is of the utmost importance that policymakers explore how to enable this shift and allow small and mid-size companies to access public equity markets.

Obviously, banks will continue to play a role in providing working capital to growing businesses. Therefore, it is important to ensure that any banking sector reforms do not prohibit or restrict the availability of such bank finance for SMEs.

Q19 What policy measures could increase retail investment? What else could be done to empower and protect EU citizens accessing capital markets?

Please see our response to Q1 and Q5. We believe that the proposals enumerated in our answer to these questions would promote investment by private EU citizens by addressing certain regulations that prohibit private involvement either directly or indirectly (e.g. Prospectus Directive).

Private investors play a significant role in providing investment for small and mid-size quoted companies, in the UK and other Member States. We believe that in recent years policymakers have ignored this role in favour of a concentration on ‘investor protection’, rather than ‘investor enablement’.

There are a number of potential obstacles arising from regulations that lock private investors out of money raisings, thus cutting off a source of funding for these companies. If these rules were adjusted so that

private investors could be more involved in the small and mid-size quoted company sector (and have access to a higher-level of information about their investments in order to ensure investor protection) then there would be increased liquidity for these companies, which would make the market function more efficiently.

We believe that companies should also be seen as consumers of the capital markets, and as such should benefit from adequate levels of support and protection in policy and regulation that can encourage and enable their growth potential, stability and development.

Q20 Are there national best practices in the development of simple and transparent investment products for consumers which can be shared?

Please see our response to Q1 and Q5. We believe that applying these proposals would ensure that the EU is a globally attractive place to invest.

Q23 Are there mechanisms to improve the functioning and efficiency of markets not covered in this paper, particularly in the areas of equity and bond market functioning and liquidity?

Please see our response to Q1 and Q5. It is important to highlight the impact of certain pieces of legislation (e.g. CSDr and MiFID II) on small and mid-size quoted companies' ability to raise finance.

Q24 In your view, are there areas where the single rulebook remains insufficiently developed?

We believe that Member States and local markets must have flexibility at times to allow for different national environments and trends regarding raising equity finance. Nevertheless, the Commission should assess whether there are obstacles to the single rulebook arising from goldplating legislation by Member States – which should be minimised.

Q25 Do you think that the powers of the ESAs to ensure consistent supervision are sufficient? What additional measures relating to EU level supervision would materially contribute to developing a capital markets union?

We believe that it is essential to include more representation of smaller listed companies and associations within ESMA. This would help to ensure that policy and regulations are more fit for purpose at the right time.

Also, the Commission should ensure that there is a requirement for ESMA to take into account the views of the ESMA Stakeholder Group. ESMA should be required to perform market impact assessments which specifically take into account small and mid-size quoted companies rather than look at the market as a whole. An SME Asset Class would assist this.

Q28 What are the main obstacles to integrated capital markets arising from company law, including corporate governance? Are there targeted measures which could contribute to overcoming them?

The challenges of company law compatibility across the European Union remain apparent. Many jurisdictions operate under regimes which make it difficult to operate a company and that is unhelpful.

More importantly, we continue to strongly believe that it is vital for corporate governance to remain principles-based and to be applied following 'comply or explain'. The EU should not impose regulatory

initiatives in corporate governance – this must be developed on a Member State level due to the different national environments. Instead, the EU should encourage deeper coordination between Member States and competent authorities as to examples of good corporate governance and effective disclosure by issuers.

We believe that different codes should be developed within Member States, reflective of the different characteristics of issuers, including their stage of development, investor base and the appetite of their investors. The Quoted Companies Alliance Corporate Governance Code for Small and Mid-Size Quoted Companies (most recent edition May 2013) is an outcome-orientated approach to corporate governance, appropriate for smaller UK quoted companies, which could provide a useful example for codes which could be developed for other markets for similar companies in different countries.

On an EU level, the European Commission could support increased visibility and promotion of corporate governance (e.g. fund surveys to monitor trends in compliance/explanations). We would emphasise that it would be extremely difficult and impractical to introduce a unilateral model of corporate governance across Member States, given their inherent differences.

Q29 What specific aspects of insolvency laws would need to be harmonised in order to support the emergence of a pan-European capital market?

We do not have any specific comments regarding insolvency laws. We would emphasise that the goal should not be a pan-European capital market but a single market for capital.

Q30 What barriers are there around taxation that should be looked at as a matter of priority to contribute to more integrated capital markets within the EU and a more robust funding structure at company level and through which instruments?

We would note that EU state aid rules often act as a barrier to developing new or amending existing fiscal incentives in Member States. National governments are often reluctant to change fiscal incentives due to the long and complex process of having EU approval for a change to a scheme (or use this as an excuse).

We believe that the European Commission should reconsider both the application of state aid rules and the approval process of member states' schemes in order to ensure that these regulations are not a brake to developing the necessary incentives that are vital for the growth of small and mid-size quoted companies throughout Europe.

Currently tax systems throughout Europe, and specifically in the UK, are skewed to encourage companies to raise temporary debt finance rather than permanent equity. This "tax bias in favour of debt in corporate taxation" is mentioned in the Commission Staff Working Paper accompanying the CMU Green Paper as discouraging "the development of loss and shock-absorbing equity markets across the EU". [12]

Indeed, in the UK, there is a specific entitlement to claim a tax deduction for costs incurred in raising debt finance, whereas the costs of raising finance through the issue of equity are not tax deductible. This represents an unnecessary and pronounced distortion in the tax system, which has been referenced in the

[12] See Commission Staff Working Document accompanying the Capital Markets Union Green Paper, available here http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015SC0013&from=EN.

recent Mirrlees Review and raised in a number of debates surrounding the causes and consequences of the financial crisis.

For a small and mid-size quoted company, this cost represents a disproportionately large percentage of funds being raised and is, therefore, a major disincentive to seeking a public equity listing. As pointed out in the Commission Staff Working Document mentioned above, the process of producing a prospectus and getting it approved by the national competent authority can be "expensive, complex and time-consuming, especially for smaller companies". [13] As a result, quoted SMEs must stay within the available exemptions from the requirement to produce a prospectus or look for financing elsewhere, such as debt finance from banks.

Member States should be encouraged to bring in tax measures that level the playing-field between raising debt and equity, for example, through allowing the costs of raising equity to be tax deductible or limiting the amount of interest that is tax deductible. This would lower the cost of capital of SMEs seeking to access public equity markets and correct an imbalance in the tax treatment of equity and debt.

We believe that the European Commission and Member States should explore whether there are aspects of the European tax system that unduly favour private equity/venture capital finance in comparison to public equity.

Q31 How can the EU best support the development by the market of new technologies and business models, to the benefit of integrated and efficient capital markets?

We believe that there should be political support for commercial initiatives to pool research so that it is accessible across the EU.

The Commission should initiate a pan-European review of the IPO process to ensure that there is more transparency to the allocation process by investment banks to institutional and private investors. More transparency over money raisings on public markets would raise confidence and potentially reduce costs.

Q32 Are there other issues, not identified in this Green Paper, which in your view require action to achieve a Capital Markets Union? If so, what are they and what form could such action take?

Indices provide a key level of market transparency, together with share prices and other trading data. Much work has been done to raise levels of transparency in trading data. The Commission should initiate a study of how indices (and other market data) could be used to promote more liquidity in the smaller listed company segment of each national market.

The Commission should consider very seriously how social policies are implemented (e.g. non financial reporting issues such as diversity). Listed companies should not be used as the only vehicle for any social policy. Using listed companies inevitably involves small growth companies which have limited resources to implement such policies, thus hampering their ability to grow. Forcing social policies through on narrow channel is inefficient and damage the attractiveness of public equity markets when compared to other forms of finance.

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[13] See Commission Staff Working Document accompanying the Capital Markets Union Green Paper, available here http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52015SC0013&from=EN.

We believe that small listed companies should be exempted from such policies. If a social policy is worthwhile it should be taken up by all large companies, whether public or private to have maximum effect. The exclusion of small and mid-size quoted companies could be assisted by introducing an SME Asset Class.

The European Commission should measure annually the economic contribution of the aggregate of companies with a market capitalisation below €200m. By raising awareness of the economic contribution, by annual tracking of such data, more political and investor interest will be created. This tracking data will help inform policy making.

Initiatives such as the London Stock Exchange's ELITE programme should be promoted across all markets.

Please see also our answer to Q1.

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

Yours faithfully,

Tim Ward
Chief Executive