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Primary Markets Policy
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12 May 2017

Dear Sirs,

DP17/2 Review of the Effectiveness of Primary Markets: The UK Primary Markets Landscape

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.

We welcome the opportunity to respond to the FCA's discussion paper on the UK primary markets landscape as part of its wider review of primary markets' effectiveness.

The Quoted Companies Alliance Legal and Primary Markets Expert Groups have examined your proposals and advised on this response. A list of members of the Expert Group is at Appendix A.

Responses to specific questions

Q1.1 Are there any issues or aspects of the listing regime not covered in this paper that you think we should be discussing? If so, please provide more detail.

We note that the majority of the policy and discussion material in this paper was devised prior to the UK's vote to leave the European Union in June 2016. Subsequently, it is essential that any further discourse regarding the UK primary markets landscape centres on the distinct need to ensure that the regulatory architecture for London's capital markets maintains the market's competitiveness and attractiveness after the UK has left the European Union. Naturally, the outcome of the negotiations – which is currently difficult to predict – will play a key part on the future of the UK primary market landscape.

As a general observation, we believe that Figure 1 on page 43 does not show an accurate picture of the number of listed UK companies (on all markets). The data does not separate out international companies and includes investment companies (which invest in other companies on the market providing an element of double counting).

Taking this into account we estimate that the number of listed UK companies is about 530 on the Main Market and 950 on AIM. This indicates that there may be an underlying trend that is starker than that shown in Figure 1.

We do not think that the reason for the fall in numbers of companies using the stock market is due to the number of delistings. OECD research indicates that there has been a general decline in companies on the stock market due to the fact that there is a dearth of smaller companies joining the markets.[1] The average size of IPO companies has risen significantly which may indicate that the cost of accessing public equity capital is becoming too high for growth companies that previously would have been able to benefit from such finance.

The FCA should have within its operating objectives a requirement to consider growth and productivity to ensure that the public equity markets are open to as many growth companies as possible whilst ensuring that investors are sufficiently educated to recognise the risks and rewards involved.

International companies should be considered separately from listed UK companies to ensure that due consideration is given to both, particularly when the FCA is considering the development of an international market separate from the Main Market.

Q3.1 Do you have any comments on the underlying rationale for standard listing? Are the key assumptions on which the regime was built, including equality of treatment between UK and non-UK companies, still valid?

We believe that much of the original rationale for establishing the standard listing regime remains valid.

Regarding premium listings, we broadly agree that equality of treatment between UK and overseas companies is important and overseas companies should not be exempt from complying with the premium listing regime.

The UK listing regime should be flexible and offer alternative options to issuers that do not meet the "super-equivalent" requirements for a premium listing. For these issuers, the standard listing regime does provide a useful route to the market. If the segment was removed, it is entirely possible that issuers may choose to list in the EU member states that offer an "EU directive minimum" regime.

Whilst we recognise that there are legitimate concerns expressed by market participants about the segment – for example, regarding insufficient liquidity, a perception of less stringent regulations, a lack of indexation and a general lack of clarity among investors about the market – we also note that there are several examples of significant issuers choosing a standard listing.

The removal of shareholder approval for significant transactions under the class tests offered by the segment is a major benefit to acquisitive companies and special purpose acquisition companies (SPACs) in particular.

There have been several notable examples of experienced entrepreneurs using SPACs for very significant fundraisings and acquisitions which have been backed by strong institutional support (e.g. Horizon Acquisition Company, Justice Holdings, Nomad Holdings and Atlas Mara). We note that a number of significant trading businesses have also opted for the standard segment (e.g. AA plc, at least when it listed in 2014).

We are therefore in favour of retaining the Standard segment in order to provide flexibility in the UK's primary markets.

[1] http://search.oecd.org/daf/ca/BFO-2016-Ch4-Stock-Exchanges.pdf

Q3.2 Do you think the name 'standard listing' is unattractive to prospective applicants? What alternative suggestions do you have?

We suspect the name probably does have negative connotations in the eyes of some potential applicants. However, we do not have any specific suggestions for an alternative name but one approach might be to pick an acronym which may catch on instead of the full name (like AIM), or an unrelated word.

Alternatively, it may be useful to refer to the 'standard listing' as a 'regulated listing'. This would reflect the concept of admitting securities to trading on a Regulated Market.

Q3.3 What are your views on development of a distinct international segment? If you think it would be beneficial, what investor protections should apply? What, if any, alternative proposals would you put forward to assist non-UK issuers wishing to raise equity capital in the UK?

We acknowledge that a distinct segment which is subject to less regulation than the premium segment could in some cases be attractive to large overseas issuers seeking a dual listing.

However, we are concerned that such a segment could overly complicate the range of markets, and the corresponding levels of regulation, available to issuers and investors. There is also a risk that a further, separate segment may undermine the advantages of seeking a premium listing. For example, a new segment where overseas issuers are eligible for FTSE index inclusion may reduce the number of issuers wishing to list on the premium segment and therefore undermine its prestigious reputation and success as a listing destination.

If it is intended that the new international segment will impose less regulation on overseas issuers than is currently imposed upon premium listed issuers, but more than the EU-minimum requirements imposed on standard listed issuers, it could be perceived that such a segment would offer overseas issuers an easier route to a more prestigious London listing. Yet this would not be available to UK issuers.

If the option was desirable, UK issuers could decide to bring themselves within it by arranging for the parent company of their group to be incorporated elsewhere than in the UK. This would further undermine the success of the premium segment.

We believe that it would be better to focus on enhancing the current premium listing segment so that it is both attractive to overseas issuers and not disadvantaging UK issuers. One measure would be to modify the minimum free float requirements; this is one of the main reasons why issuers choose to list elsewhere.

Another concern for issuers is liquidity. UK investors have become increasingly willing to invest in overseas securities directly on local exchanges. This is likely to be one reason why dual listings have continued to decline. It is therefore unclear if a new segment would in itself create further demand amongst investors.

As the Discussion Paper acknowledges, the key challenge will be to create a sensible package of investor protections. We agree that the approach suggested in paragraph 3.22 of DP17/2 may be broadly appropriate for a large overseas issuer.

Q3.4 Do you think that the premium listing obligations for open-ended investment companies should be removed, and the securities category repositioned in the standard listing segment? In arriving at your view, what factors have you taken into account?

We agree that providing greater flexibility for ETFs by removing premium listing obligations is welcome (notwithstanding the existence of the Specialist Funds Segment). In our members' experience, open-ended investment companies are treated very differently from most other companies subject to the premium listing requirements. The main source of investor confidence derives from the regulatory framework that applies to collective investment funds rather than the listing regime.

Q3.5 Are there any individual elements of the premium listing regime that should be retained for open-ended investment companies? If so, what are they and why should they be retained?

We do not believe that there are any specific elements of the premium listing regime that should be retained which would not otherwise apply to open-ended investment companies by virtue of being a standard listed company.

Q4.1 How effective are the UK's primary equity markets in providing capital for science and technology companies in the scale-up phase?

We share the views expressed in the discussion paper that the UK's primary markets are less effective than others in providing scale-up capital for science and technology companies (STCs). However, identifying the specific reasons for this is extremely difficult as the issues are complex. We outline some of these in our answer to Q4.2.

Q4.2 What are the factors that adversely impact the effectiveness of the UK's public equity markets in providing scale-up capital?

I. <u>Equity market structure and disproportionate regulation</u>

The combination of universal, punitive regulatory and administrative requirements is one of the main factors adversely impacting the effectiveness of the UK's public equity markets in providing scale-up capital to companies seeking to grow. Too often, new rules are developed with larger companies in mind, without sufficiently taking into account the ability of smaller companies to comply. A requirement that may be reasonable for a large company to adhere to is often a disproportionate requirement for smaller companies.

II. <u>Rigid corporate ownership models</u>

Another area that adversely impacts the effectiveness of the UK's public equity markets in providing scale-up capital is the UK market's rigid adherence to certain shareholder protections, including the rules preventing dual share structures.

For STCs in particular, the presumption that companies with different voting rights cannot list is unhelpful when such principles are not regarded as important in other jurisdictions where investors are comfortable with such structures. Indeed, the Swedish experience, where 40% of all companies on the Swedish stock market, including the growth market First North, have some form of variable voting right structure, demonstrates that investors can be comfortable with such structures.

Similarly, Google and Facebook's ability to raise capital despite offering differentiated voting rights has held neither back. The traditional view should be challenged if the UK's primary markets are to provide a credible alternative to attract certain STCs whose founders wish to retain greater control in order to deliver their "vision" and can choose to list elsewhere in order to avoid these restrictions. Our view is that this traditional approach in the UK is driven principally by investors rather than regulators.

III. Investment culture

There is a perception, rightly or wrongly, that larger STCs can achieve higher valuations in the US (particularly on NASDAQ) because it is a significantly bigger market than the UK with a deeper pool of sector-focussed analysts. Furthermore, there is a tendency for UK investors to exit their investments in STCs by M&A transactions at a much earlier stage than in the US and it is difficult to see how any changes in the regulatory framework could in themselves bring about a shift in short-term to long-term behaviours, which in themselves may also be affected by a more risk averse culture in London, compared with the US.

We note that a long-term approach has already been encouraged, particularly by the Financial Reporting Council through its Stewardship Code and its revisions to the UK Corporate Governance Code though we question the effect they have had on improving long-term investment.

Furthermore, the eligibility criteria in the Listing Rules can act as an obstacle to high growth companies seeking to list on a public equity market. For example, a company that has grown rapidly over a three year period could find itself not fulfilling the requirement to possess representative historical information as a result of a significant change in its scale of operations during the period of historical financial information, as stated in LR 6.1.3E (5) (which will soon be transposed into LR 6.3.2G (2) (e)). This would appear to disincentivise companies from seeking growth and contradict the objective of encouraging high growth companies to harness the potential public equity.

Q4.3 What potential enhancements to the primary market regulatory framework could contribute to improving the provision of scale-up capital?

As a general comment, the FCA, alongside the Government, must focus on the needs of small companies when considering amendments to the primary market regulatory framework. As we noted in Q4.2, requirements deemed suitable for the largest companies are often ill-suited for small, growing companies and unnecessarily erect barriers to growth.

Q4.4 Should science and technology companies have reached a certain stage of business maturity before accessing public equity markets? If so, how should that stage of maturity be defined?

In terms of mitigating risk for investors, it would be desirable in principle for STCs to come to the market at a relatively more mature stage in their development when the business or product has been proven or "de-risked" to some extent.

However, in practical terms, it is difficult to define the appropriate level of maturity in the context of the regulatory framework, so that it can be applied across many different types of business or industries. STCs and their underlying products or technologies develop at vastly different rates and depend on the particular sector or industry in which they operate.

STCs in particular need to be assessed on a case-by-case basis; their risk profiles will vary significantly. For example, early stage genuinely disruptive technologies or products with a first-mover advantage may be just as appropriate for a public market as a more mature STC with a proven concept.

Q4.5 What are the characteristics of the capital market structures that drive short-term behaviours?

The capital market structure allows the possibility of a secondary market as well as a primary market. It is the possibility of being offered a price and a trading possibility at any time that facilitates short-term behaviours. However, short-term behaviours provide essential liquidity to the capital market. Policymakers should exercise caution in presuming that long-term investors are always intrinsically more beneficial than short-term investors. A capital market comprised only of long-term investors would not be an efficient venue for price formation as it would be highly illiquid and therefore be exposed to potentially highly volatile and erratic price swings.

Q4.6 What are the drivers of these characteristics, and how important is regulation in this context? What changes could be made to help address these drivers?

Please see our answer to Q4.5.

Q4.7 The current public equity capital market model provides different things. How important are each to the long-term investor? How important are each to early-stage issuers? Are there additional important features of public equity markets not mentioned below?

a. **Corporate transparency (through listing documentation, periodic financial information, and ad hoc announcements)** – Transparency is essential to the integrity of capital markets. It creates trust and confidence between investors and issuers. Furthermore, it enables investors to make informed decisions, while also reducing the cost of capital for issuers.

b. **Due diligence by experts and third parties (such as lawyers, accountants, sponsors and sector specialists)** – Like corporate transparency, due diligence is part of the trust-building process. Investors tell us that although they may not read a prospectus comprehensively they do take assurance from the knowledge that due diligence and verification has taken place.

c. **Investor stewardship** – Effective investor stewardship enhances the level of engagement between companies and investors which can in turn both improve the standard of corporate governance and generate long-term shareholder value.

d. **Regulatory oversight (such as the assessment of issuers against eligibility criteria, and the scrutiny of listing documentation**) – Comfort is taken by investors from the listing process. However, it is difficult to scientifically measure what comfort is derived by consumers from this process and to determine whether consumers are getting value for money.

   The process may implicitly encourage advisers to apply lower quality thresholds to their documentation because they know that it will be checked and scrutinised by the UKLA. They may also be less equivocal to potential issuers about eligibility knowing that a further review will be conducted by the UKLA.

   The FCA and UKLA should ensure that a regular cost benefit exercise is undertaken to ensure that the work performed by the UKLA is commensurate with the need to ensure consumer confidence. Pre-vetting should not be taken as a given. Post-vetting should also be considered for low risk issues. It should not be assumed that the work of the UKLA and the resources currently applied are at the right level (they may be too low, too high or appropriate) to inspire consumer confidence. This should be thoroughly and publicly tested.

When referring to consumers we mean issuers as well as investors.

e. **Corporate governance requirements or other investor protections (such as pre-emption rights)** – Good corporate governance is a vital component for an early-stage, growing company wishing to reduce its risks and attract long-term investment. Playing a significant role in a fund manager’s decision to invest, a company able to effectively embed appropriate processes and values can better inspire trust from investors, which in turn reduces the cost of capital.

f. **‘Listed’ status (e.g. for investment mandate or tax purposes)** – ’Listed’ status is important and provides confidence to more than just investors, including tax authorities.

g. **Coverage by research analysts –** Sufficient coverage by research analysts is essential for early-stage companies securing interest and long-term investment from investors. At the same time, research is important to investors because, if done to a high standard, it can effectively summarise a company’s business activities and provide a strategic appraisal of the business, allowing investors to make an informed investment decision.

   It should be noted that the impact of MiFID II on small and mid-size quoted companies should not be underestimated. This is likely to accelerate the demise of independent research in this sector. This will, inevitably, reduce transparency and liquidity. There may also be an increase in market abuse due to the lower level of scrutiny.

   This regulation will have the intended effect on payments for research on the largest most liquid stocks but will have an opposite and damaging effect on small and mid-size quoted companies. The cost-benefits analysis should be split into three parts: for the market as a whole; for the largest and most liquid securities on the market (e.g. those listed on the FTSE 100 or FTSE 350); and the securities of small and mid-size quoted companies. This will increase the chance of the FCA and others recognising the disproportionate impact of a regulation on growth companies with no real regulatory benefit.

h. **A platform for further fund-raising from existing or new investors** – It is essential that innovation is encouraged in the primary markets to extend the ways in which early stage, scale-up and growth companies can access finance and liquidity, and benefit from secondary trading in their shares. It is also essential that the process by which these platforms and markets are recognised by the FCA is as efficient and timely as possible. Innovation should be encouraged.

i. **Indexation** – Indexation is a key part of attracting liquidity. The methodology for inclusion of indices should be easily accessible by consumers.

   The constituents of indices and their relative weightings should be well publicised so that consumers can understand the impact the single stocks can have on their funds and ETF performance. Taking the FTSE 100 as an example, as of 28 April 2017, the top 10 holdings accounted for 42% of the market capitalisation of the index. Perhaps even more crucially, the top 10 holdings in the FTSE All Share accounted for 33% of that index’s market capitalisation.

   The FCA should ensure that funds benchmarked against specific indices are appropriately named. For example, labelling a so-called UK Fund - benchmarked against the FTSE 100 or the FTSE All Share - is in effect benchmarking its performance against global stocks that happen to be headquartered in the UK. Given the weightings described above is this really a UK Fund that consumers are investing in?

The producers of major indices should not require that stocks have to be traded on a particular exchange. If a stock is large enough, by way of market capitalisation and liquidity, then the market should be irrelevant.

The inclusion of overseas stocks in national indices should also be reviewed.

j. **The ability to trade investments** – Liquidity is an essential ingredient in a healthy capital market. However, the smaller growth company sector will always have less liquid, even illiquid, stocks. This should be recognised and rules and regulations should reflect this, trying to optimise what liquidity there is.

   Ensuring that each stock is traded on the trading platform that optimise such liquidity is essential and the FCA should regularly review this to ensure that this is the case.

k. **Price discovery and value discovery** – Trade reporting and price discovery are essential features of the market. In the smaller quoted market, where liquidity is low, market-makers play a crucial role. They should be able to withhold reporting trades while an order is worked, in order to ensure that volatility is reduced and confidence amongst large institutional shareholders is retained.

   Issues arising from the Central Securities Depositories Regulation and the Short Selling Regulations should be addressed as soon as possible to ensure that market makers are not penalised and forced to stop making markets in less-liquid stocks. This reinforces the notion that cost benefit analyses should consider the small and mid-size quoted sector separately. What is good for the large liquid stocks is often wholly inappropriate for the growth company sector.

Q4.8 What features would a long-term capital market need to have, and need to avoid, to be effective?

The small and mid-size quoted company sector has many features of a long-term capital market which are absent in the more liquid securities of larger companies. The securities of smaller companies are relatively illiquid and therefore institutional and private investors understand that they must build the stake patiently to build a large stake. Their initial appraisal of the company will inevitably be influenced by how simple it will be to sell the stock. If it does not perform, it may be impossible or take a great deal of time when the share price is falling.

Furthermore, in contrast to securities of larger companies, institutional investors can assume relatively large stakes of at least 15%. This gives them the ability to challenge issuers in a more direct way than they could for FTSE 100 companies. This facilitates a higher level of engagement between investors and the company.

For a long-term capital market to flourish the different sizes of companies need to have different types of characteristics in trading platforms, trade reporting, clearing and settlement. Homogenisation does not create effective markets.

Q5.1 Do you think there is an opportunity in the UK for a new wholesale bond MTF? If so, where is the opportunity and why? Please specify products, sectors and geographies.

Yes, there is an opportunity for a new wholesale bond MTF in the UK and we would welcome it. Raising public debt by growth companies could become an effective way to raise capital before a company takes the bigger step of issuing equity on a public market. Currently the minimum size of debt that can be raised is too high for many growth companies that wish to access relatively cheap debt.

Q5.2 To what extent do you think investors understand the differences between MTFs and Regulated Markets and the differing levels of investor protection which apply to them? Does your answer differ when considering different types of investor (e.g. retail versus wholesale)?

It is 20 years since the introduction of the MTF called AIM. Investors have had sufficient time to recognise the differences between an MTF and a regulated market. We do not detect any lack of understanding between the two types of markets. The risks are well understood. Inevitably there are corporate failures on both types of market and the rules and corporate governance requirements rightly come under scrutiny in these instances. However, this does not, of itself, indicate a lack of understanding.

Q5.3 Do you believe a specialist wholesale bond MTF could be a commercially viable proposition without RSE status?

This is not a question that we feel able to give an opinion on. We would welcome the introduction of a specialist wholesale bond MTF where there is a balance between appropriate investor protections and an attractive, affordable capital market for issuers.

Q5.4 Do you believe the creation of a new wholesale bond-focused MTF would be in the wider interests of investors?

Yes, but as you suggest in question Q5.3 this should be a specialist market for specialist investors who understand the risks.

Q5.5 Do you have any comments on the key elements of a possible listed wholesale bond MTF we outline above?

See our answer to Q5.4.

Q6.1 Do you agree that there are forms of issuance which could be issued to retail investors from programme documentation without the need for the more intensive scrutiny from us that is set out in our existing guidance on retail bonds?

We have no comments.

Q6.2 What criteria should be considered in seeking to identify relevant issuance?

We have no comments.

Q6.3 Should such issuance be clearly labelled or identified, and, if so, in what way?

We have no comments.

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

Yours faithfully,

Tim Ward
Chief Executive

APPENDIX A

Quoted Companies Alliance Legal Expert Group

Gary Thorpe (Chairman)	**Clyde & Co LLP**
Maegen Morrison (Deputy Chairman)	Hogan Lovells International LLP
David Davies	Bates Wells & Braithwaite LLP
Martin Kay	Blake Morgan
Paul Arathoon	Charles Russell Speechlys LLP
David Hicks	Charles Russell Speechlys LLP
Mark Taylor	Dorsey & Whitney
Jane Wang	Fasken Martineau LLP
Richard Pull	Hamlins LLP
Nicholas Narraway	Hewitson Moorhead
Danette Antao	Hogan Lovells International LLP
Donald Stewart	Kepstorn
Nicola Mallett	Lewis Silkin
David Wilbe	Lewis Silkin
Tara Hogg	LexisNexis
Stephen Hamilton	Mills & Reeve LLP
Nicholas McVeigh	Mishcon De Reya
Philippa Chatterton	Nabarro LLP
Jo Chattle	Norton Rose Fulbright LLP
Simon Cox	Norton Rose Fulbright LLP
Julie Keefe	Norton Rose Fulbright LLP
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Quoted Companies Alliance Primary Markets Group

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David Worlidge	Allenby Capital Ltd
Nick Naylor	Allenby Capital Ltd
Chris Hardie	Arden Partners Plc
David Foreman	Cantor Fitzgerald Europe
Stephen Keys	Cenkos Securities Plc
Peter Stewart	Deloitte LLP
Stuart Andrews	finnCap
Samantha Harrison	Grant Thornton UK LLP
Niall Pearson	Hybridan LLP
Richard Crawley	Liberum Capital Ltd
Tom Price	Northland Capital Partners Limited
Peter Whelan	PricewaterhouseCoopers LLP
Bidhi Bhoma	Shore Capital Group Ltd
Azhic Basirov	Smith & Williamson LLP
James Spinney	Strand Hanson Limited
Paul Shackleton	W.H. Ireland Group Plc