Quoted Companies Alliance

6 Kinghorn Street
London EC1A 7HW

T +44 (0)20 7600 3745
F +44 (0)20 7600 8288
mail@theqca.com

www.theqca.com

London Stock Exchange
10 Paternoster Row
London
EC4M 7LS

aimnotices@lseg.com

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Dear Sirs,

**AIM Rules Review**

We welcome the opportunity to respond to London Stock Exchange's review of the AIM Rules. AIM companies make a substantial contribution to the economy. With the UK poised to leave the European Union in March 2019, it is essential that Europe's premier growth market continues to operate effectively and allows innovative companies to contribute to generating sustainable economic growth.

We have responded below in more detail to the specific amendments from the point of view of our members, small and mid-size quoted companies.

***Responses to specific questions***

**I. The role of London Stock Exchange**

**Q1 Do you agree that the proposed extension and codification of the existing early notification process would be beneficial?**

Yes, we agree that the proposed extension and codification of the existing early notification process would be beneficial in relation to the appropriateness of a prospective applicant.

As the conditions for entry to AIM are designed to be limited, formalising an early discussion on the appropriateness of a prospective applicant will avoid situations where obstacles to admission are not identified until after a prospective applicant has incurred significant costs relating to the proposed admission. It will also ensure that London Stock Exchange is able to make its views known at an early stage.

However, we question whether the process is necessary for some re-admissions – particularly in the case of reverse takeovers under AIM Rule 14, which have the characteristics of a substantial business acquisition rather than a new applicant to the market. We would encourage London Stock Exchange to consider exempting these from the new process.

The current process for reverse takeovers works well and an early notification obligation would not be suitable in such circumstances. We would also suggest that any proposed early notification obligation should not apply to a company admitted to AIM under the designated market route.

**Q2 At what point should this early notification be required in order to make it feasible for the nominated adviser to have identified the information required but also early enough in the process to enable the discussion to have a benefit to the parties in their preparation for admission?**

There is a challenge in getting the balance right between minimising potential costs by having an early dialogue, delaying notification until sufficient work has been carried out in order to verify the relevant information and having sufficient time to analyse its potential impact.

The stage at which a nominated adviser can identify the required information varies between transactions. Nominated advisers should be able to assess when the appropriate time to approach London Stock Exchange is, once it has considered the overall timetable and when it has assessed whether all the required information relating to the applicant has been identified. This would maintain a degree of flexibility for all parties. An appropriate timeframe might be approximately two months before the intended date of admission.

If the focus of the early notification is made more explicitly about appropriateness issues, the scope of the initial due diligence can be better focused on this area. This will both expedite the notification and minimise cost where a possible obstacle may emerge.

However, the principal objective should be to have a dialogue sooner, rather than later, in the due diligence process. We recognise that AIM Regulation may not have sufficient resources to accommodate a potential increase in such dialogues, but would contend nonetheless that it would be beneficial if London Stock Exchange ensured that AIM Regulation had sufficient “bandwidth” to engage in an advantageous outcome for future market participants.

Furthermore, there must be a transparent and accountable decision-making process to which London Stock Exchange adheres. It should commit to a maximum time period for responding following the submission of all material data. We would suggest a period of no longer than ten business days from the receipt of the early notification to respond; this would align with the Schedule 1 submission procedure.

**Q3 Does the list proposed at section 4 cover the key information that should be set out in the early notification process and, if not, what additional information would be beneficial?**

The list given is based on the existing Schedule 1 notification. The information provided to London Stock Exchange pursuant to Schedule 1 is intended to be a summary of the key corporate information relating to the applicant.

Schedule 1’s existing process should be retained, complete with its existing content requirement. However, we consider that the earlier discussion process should focus on the appropriateness criteria discussed and illustrated in the sections headed “The role of the nominated adviser” (p.6) and “Guidance on when the Exchange may exercise its AIM Rule 9 powers” (pp.7-8).

**Q4 Do you agree that it would be helpful to publish a list of non-exhaustive examples of factors to be taken into account by nominated advisers when assessing appropriateness for AIM?**

Yes, we agree that it would be helpful to publish a list of non-exhaustive examples of factors to be taken into account by nominated advisers when assessing appropriateness for AIM.

Although nominated advisers have a great deal of experience on ascertaining what is an 'appropriate applicant' gained from regularly advising on the AIM Rules, their regular dialogue with AIM Regulation and reviewing Inside AIM guidance, all market participants would benefit from this knowledge being collated into a single document– whether incorporated as a schedule to the AIM Rulebook or as a standalone document. It would provide clarity and transparency to potential applicants and their nominated advisers and should reduce the number of unsuitable applicants seeking an admission.

**Q5 Do you agree with or have any comments on the proposed examples at section 4?**

The proposed lists referred to in answer to Q3 above are helpful.

However, the "risks" category is somewhat unlimited in scope and may not be as helpful as simply classifying this category as a risk of investor detriment, or significant 'risk factors' that will be noted in the admission document. Furthermore, London Stock Exchange could consider adding a reference to companies based, or operating in, high-risk jurisdictions.

Furthermore, we would encourage more clarity with respect to "corporate structure and business models that give rise to concerns regarding appropriateness for a public market".

We also note that we discuss the inclusion, or otherwise, of free float further in the answer to Q6 below.

**II. The development of AIM and eligibility criteria**

**Q6 Do you agree that the current approach to free float strikes the right balance or do you consider that London Stock Exchange should consider the introduction of a minimum "shares in public hands" requirement?**

Yes, we agree that the current approach to free float strikes the right balance. We note that in our Small and Mid-Cap Investors Survey[1], which we jointly published with RSM in March 2017, the majority of institutional investors believed there should not be any kind of enforced minimum free float, either by value of company or size of shareholding floated, as it is unnecessary and burdensome.

It is also worth noting that the current unwritten rules on free float are generally understood by advisers and regulators. However, prospective companies are typically not familiar with the AIM admission process and these unwritten rules are neither published nor consistent with the AIM Rules text.

London Stock Exchange should review the reference to "the participation of recognised institutional shareholders" as an admission suitability factor. This could unintentionally suggest that London Stock Exchange sees the market as having two classes of investor, with retail investors classed as subordinate to institutional investors. This reference risks deterring growth companies which are below an institutional investment market capitalisation criterion, and subsequently damaging the market. We believe London Stock Exchange should consider appropriate steps to encourage the participation of retail investors in fund raisings.

[1] Small and Mid-Cap Investors Survey 2017:
http://www.theqca.com/article_assets/articledir_256/128121/QCA_RSM_Small_and_Mid-Cap_Investors_Survey_2017_Report.pdf

**Q7 If you believe London Stock Exchange should consider introducing a specific free float requirement, what would you consider to be an appropriate minimum and the reasons why? What types of shareholders should be considered as "shares in public hands"?**

As we stated in our answer to Q6, we do not consider the introduction of specific free float requirements as necessary.

However, if London Stock Exchange decided to offer guidance, rather than a requirement, we would encourage discrete minimum free float guidance for companies seeking to be admitted on AIM. A 15% target may be an appropriate minimum, although that may be insufficient to ensure an appropriate level of secondary market liquidity for some smaller companies. Accordingly, we would encourage London Stock Exchange to consider dual guidance criteria of a minimum free float target of 15% or a minimum value of £1m.

**Q8 Do you believe that it would be beneficial to extend minimum fundraising criteria at admission, or should it continue to only apply to AIM investing companies?**

We do not believe that extending minimum fundraising criteria to all AIM companies is necessary. The benefits seem uncertain, potentially minor and would make introductions (where no funds are raised) to AIM more challenging.

Setting a general fundraising requirement would inhibit established, well-funded companies with existing diverse shareholder bases from seeking admission. This would potentially deny appropriate overseas quoted companies from seeking an AIM quotation or even transfers from the Main Market. It would also deny private well-funded companies from seeking an AIM quotation to facilitate employee incentivisation and representation and/or diversify their shareholder base by allowing existing shareholders to sell shares at the point of admission.

If the suggestion of a £6m minimum fundraise requirement had been in place since 1 January 2015, then based on the Exchange's own statistics, 63 admissions to AIM would not have been able to take place. This represents 38% of the admissions to AIM between 1 January 2015 and 31 July 2017, which have themselves been supported by London Stock Exchange.

We consider that it could be appropriate to add "not raising sufficient funds at AIM admission to fully execute the business plan or encourage adequate secondary market liquidity" to the list of factors that may give rise to concerns, could help in indicating that using AIM to raise funds at the point of admission is preferable but not mandatory.

**Q9 Do you agree that such a proposal should only apply only to non-revenue generating companies? If yes or no, please explain why.**

Very few groups generate no revenue; we consider that devising a rule which would be so infrequently applied as unnecessary. In any case, this would be covered during the early notification process.

Furthermore, many pre-revenue companies tend to raise funding in stages against delivery of developmental milestones rather than all in one tranche. This helps to mitigate the higher risk to funders that such early-stage companies intrinsically create. Therefore setting too high a funding target may inhibit such companies from pursuing the AIM opportunity.

If the implication of this proposal is that the Exchange is questioning the appropriateness of early stage companies using AIM then we would contend that this represents a significant shift in policy from when AIM was founded and we do not believe that this would necessarily be supported by the investment community.

**Q10 If a threshold is introduced, what level of minimum fundraising would be most appropriate on or immediately before admission and why?**

**a) £2m**

**b) £3m**

**c) £6m**

**d) Other**

As we stated in Q8, we do not believe that there should be any kind of enforced minimum fundraising criteria for all AIM companies on admission.

However, if the consensus is that a threshold should be introduced then it should not be greater than £2m. A higher minimum fundraising level would disincentivise ambitious, entrepreneurial growth companies from seeking capital on public markets. We believe a £6m threshold would seriously damage AIM's future prospects (see answer to Q8). As there is little clarity regarding the benefits of any threshold, we strongly encourage any threshold, if supported more widely, to be set at a low level.

**Q11 Are there any other circumstance where a company should not have to meet minimum fundraising criteria, beyond those referred to above with respect to companies with a historic track record?**

Establishing a comprehensive list of when companies should not have to meet minimum fundraising criteria is challenging. At the most fundamental level of analysis, it would be those companies that are either not in need of funding at the time of admission that should be exempt from a minimum fundraising requirement. As the benefits are uncertain, we believe it is preferable not to have a minimum fundraising criterion.

**III. Corporate governance requirements for AIM companies**

**Q12 Do you consider the current requirements set out in section 6, including duties of the nominated adviser at admission to consider the efficacy of the board and the adoption of appropriate corporate governance standards and disclosure under AIM Rule 26, to be effective? If not, please explain why?**

We believe that the current requirements have contributed to improving the standard of corporate governance on AIM. At the time the current requirements were adopted, there was some resistance from the market to its inclusion. We believe that the current rule has grown to become accepted, although there remains room for improvement. In particular, the standard of corporate governance disclosure needs to be raised so that investors can understand what measures companies are taking to maintain trust with investors and other stakeholders. Clearly incorrect or limited disclosures should be challenged by AIM Regulation, in coordination with nominated advisers.

Any revised corporate governance requirements imposed on an AIM company should continue to allow that company to apply arrangements that are tailored to its individual needs, given its stage of development, and which are developed through considered engagement with its key stakeholders and advisors.

Rather than introducing new rules regarding board composition – particularly those requiring a specific number of non-executive directors and whether a board should comprise specific roles (e.g. a chair, a finance director and non-executive directors) – we would favour an approach that requires an AIM company to explain how its board is composed and explain why this is appropriate in terms of composition, the number of non-executive directors and the preservation of the independence of each office, including that of the company secretary.

With respect to the adequacy of AIM Rule 26, we support the principle that AIM companies must state which corporate governance code they have chosen to follow, if it has indeed decided to follow one. This promotes the disclosure of corporate governance arrangements. However, we think that companies should also disclose how they do this. We consider the current corporate governance disclosure requirements to be too broad, allowing some AIM companies to adopt a bland and "boilerplate" approach to their governance disclosures.

In annual reports and on websites, it is often the case that compliance with a specified governance code is claimed "…as far as is practicable for a company of our size…". Clear explanations of which elements of the code have not been adopted and what, if any, alternative measures have been taken are rarely evident. We recommend that, either directly through the AIM Rules for Companies or indirectly through reference to underlying corporate governance codes, greater guidance on the level, location and nature of corporate governance disclosures is provided.

We believe that a stronger enforcement of the application of AIM Rule 26, both in terms of pure compliance and in terms of quality of disclosure, is necessary. This may be achieved directly through the AIM Rule compliance process but may, from a financial reporting perspective, also be achieved through a greater collaboration with the FRC's Corporate Reporting Review function. This could also be done through the FRC's project on the quality of smaller quoted company reporting.

**Q13 Do you believe that AIM companies should be required to report annually against a governance code?**

We agree that AIM companies should be required to report annually against a corporate governance code. The structure and guidance provided by codified corporate governance practices allows investors and other stakeholders to be better able to benchmark a company's corporate governance arrangements. This, done responsibly and with diligent disclosure by all AIM companies, will enhance the overall integrity of the market.

As suggested, this would be achieved by requiring an AIM company to make a choice between adopting, for example, the UK Code, the QCA Code[2] or, for non-UK-incorporated companies, a similar code from their local jurisdiction. In the absence of compliance with a specific code, a company should explain fully its

[2] Quoted Companies Alliance Corporate Governance Code for Small and Mid-Size Quoted Companies (2013): http://www.theqca.com/shop/guides/86557/corporate-governance-code-for-small-and-midsize-quoted-companies-2013-downloadable-pdf.thtml

corporate governance principles and practices in sufficient detail to allow meaningful reporting against them, including the rationale for their adoption. As we have discussed with London Stock Exchange over the years, the QCA Code is a principles-based, outcome-focussed code which provides guidance on a company's approach to corporate governance within a flexible and scalable framework.

The adherence to an identified code's guidance might also promote more informative, company-specific disclosures that would lead to greater investor confidence. Adequate disclosure and explanation is an essential feature of creating confidence. Investors must be able to easily find all disclosure and AIM Regulation should make this clear in its rules.

We also note that international companies on AIM are subject to the governance standards of their home jurisdictions. In many instances these may be less stringent than UK requirements.

There are challenges and have been numerous historical problems for AIM in admitting international companies – particularly where corporate governance or culture with regards to minority shareholder rights varies from the standards of UK corporate governance. We believe that London Stock Exchange, together with nominated advisors and other corporate advisers, should actively encourage international AIM companies to apply the standards of the QCA Code as a minimum.

If there are significant divergences between the level of corporate governance standards at which an international AIM company is operating and the requirements of the QCA Code, we believe it legitimately calls into question the appropriateness for such a company to be admitted to AIM.

## IV. Standards of conduct and approach to non-compliance with the AIM Rulebooks

**Q14 Are there further ways London Stock Exchange can helpfully educate market participants, particularly individuals, as to what London Stock Exchange can and can't do in respect of its remit, beyond the information already available on its website?**

London Stock Exchange should consider participating in retail conferences to explain AIM Rulebooks. This interactive approach would be effective in educating individual market participants. Actively promoting the LSE website in social and print media is also essential to raising awareness and understanding. A long-term media campaign promoting AIM and educating investors is an essential ingredient for the success of this growth market where the risks of investing need to be clearly outlined and understood.

The existing Guide to AIM looks at both the IPO process and concludes with a short chapter on a company's responsibilities once its shares have been admitted to trading on AIM. It may be more useful to replace this guide with two publications:

- **A guide to seeking admission to AIM –** This could not only explain the IPO process but also provide useful education on appropriateness criteria; and

- **A guide to being on AIM –** This could serve as a form of manual for AIM company directors, helping to educating them on their obligations, how to get the best out of the quotation for their company and how to work with their Nomad, broker and other advisers. It could also outline London Stock Exchange's approach to enforcement of the AIM Rules.

We would also encourage London Stock Exchange to refresh its website, so that it is more user-friendly for, and more focused on educating, market participants.

**Q15 Do you agree with automatic fines for explicit breaches of the AIM Rules for Companies? If so, what types of breaches should the fine be applied to?**

Bearing in mind that explicit breaches for the AIM Rules for Companies are varied in nature, we consider the concept of automatic fines would be difficult to enforce consistently. Automatic fines for explicit breaches of the AIM Rules for Companies could also generate moral hazard; companies may judge that a fine is worth paying for a particular breach.

**Q16 In respect of Q15, what do you believe is the appropriate level of fine?**

We have no comments regarding an appropriate level of fine.

**Q17 Are there other changes to the Disciplinary Handbook that you think London Stock Exchange should consider?**

We have no further comments regarding further changes to the Disciplinary Handbook.

**V. Further comments**

As part of our response to this review, we have also detailed some additional issues that should be addressed by London Stock Exchange as it reviews the AIM Rules.

A. AIM Regulation engagement with nominated advisers

We note that, with respect to AIM Rule compliance, the approach believed to be appropriate and practical by nominated advisers can occasionally diverge from AIM Regulation's expectations. We believe that it would be beneficial for AIM Regulation to publish an annual review on the issues it, as well as nominated advisers, face in relation to AIM Rule compliance and for AIM Regulation to publish guidance, where appropriate, on what is expected. This would allow all nominated advisers to have the same guidance on the required approach to these issues.

B. AIM Note for mining, oil and gas companies

This note has not been revised since June 2009. It is very much focused on natural resource companies that own assets that are in the course of being developed or are already in operation. It therefore does not reflect the distinctive characteristics of exploration companies. Many AIM companies in the natural resources sectors are exploration rather than operating companies and so this would appear to be an oversight.

We believe that there would be a clear benefit in introducing appropriate rules and guidance for exploration companies to distinguish them from investing companies (see item D), due to the wide-ranging and imprecise definition of investing companies. The note should incorporate relevant rules and guidance reflecting the well-established commercial practices of syndicating exploration and development risk and the use of farm-in and farm-out agreements.

In addition, as the note contains rules and official guidance, we would support its incorporation into the AIM Rules for Companies as a separate chapter.

C. Investing Companies

The AIM Rules for Companies provides a definition for investing companies that could equally be applied to operating companies (or natural resource exploration companies – see item C). The reform of AIM Rule 15 at the end of 2015 helpfully distinguished shell companies from investing companies, but we believe this reform did not go far enough. The definition of an investing company should be improved by reflecting that the fundamental distinction between a commercial company and an investing company is that an investing company seeks to build a portfolio of securities or other assets with the objective of diversifying risk, whereas a commercial company seeks to operate a business with a view to making profit.

Where investments are in the form of securities, the key test must be that the investing company does not seek to obtain majority control of the composition, or votes of, an investee company's board, albeit recognising that this should not prevent activist investors from seeking to influence other shareholders from changing the composition of a company's board.

Where investments take the form of assets, the key test must be that the investing company does not seek to operate commercially such assets but only seeks to receive an economic return from them and make decisions on when such assets are acquired or disposed of.

In addition, as with natural resource companies (see item C), the rules and guidance in the AIM Note for Investing Companies should be incorporated as a chapter of the AIM Rules for Companies.

D. Share-based management incentives

London Stock Exchange should also be aware that there are strong views regarding share-based incentive plans that could significantly dilute shareholders' interests and that are not put to a shareholder vote. We recommend that a separate discussion takes place on this subject.

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